CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

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I. SUMMARY OF COMPLAINT

1. This is a securities class action on behalf of all persons who purchased or otherwise acquired the stock of AFC Enterprises, Inc. ("AFC" or the "Company") between March 2, 2001 and March 24, 2003 (the "Class Period") under Sections 11 and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§77k and 770; Sections 10(b), 20(a), and 20A of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§78j(b), and 78t(a), and the regulations promulgated thereunder by the SEC, including Rule 10b-5, 17 C.F.R. §240.10b-5.

2. During the Class Period, AFC operated, developed and franchised quick-service restaurants, bakeries and cafes under the trade names Popeye's Chicken & Biscuits, Church's Chicken, Cinnabon, Seattle's Best Coffee and Torrefazione Italia Coffee.

3. During the Class Period, Defendants consistently boasted of AFC's "record" financial performance, dazzling shareholders with AFC's seeming ability to meet or exceed Wall Street's quarterly earnings per share ("EPS") forecasts – undoubtedly, the bellwether for a public company's financial performance. But it was all an illusion created by a complex scheme of accounting manipulations orchestrated by Defendants. The scheme was designed to, and did, artificially inflate the price of AFC stock during the Class Period. As a result of the
accounting fraud, AFC’s stock price reached a Class Period high of $34.50 on April 12, 2002.

4. Defendants’ accounting misconduct was ultimately acknowledged by AFC to have spanned no fewer than twenty-one different improprieties in the Company’s financial statements. The Company’s financial results had been falsely presented by Defendants because they had:

- improperly failed to defer gains associated with restaurant sales to franchisees;

- improperly understated current expenses by various means (including improper deferral of expenses, improper capitalization of expenses and overstatement of depreciable asset lives, among others);

- failed to write down impaired assets;

- improperly overstated inventory;

- improperly understated accrued liabilities;

- improperly capitalized interest on completed construction projects;

- improperly accounted for rebates;

- improperly reduced certain lease expenses by first subtracting fictitious sublease rental income;

- failed to consolidate and include Popeye’s and Church’s advertising funds and expenses in AFC’s financial statements; and
• failed to record accruals accurately.

5. As reflected by the chart below, Defendants' accounting chicanery, among other things, enabled AFC to appear as though it was either matching or exceeding securities analysts' consensus EPS for virtually every quarter of the Class Period. In fact, just the reverse was true. AFC's actual EPS was substantially below the consensus nearly every quarter during the Class Period.

<table>
<thead>
<tr>
<th>QUARTER</th>
<th>ACTUAL EPS</th>
<th>ANALYST CONSENSUS EPS</th>
<th>RESTATED EPS</th>
<th>% BY WHICH FORECAST WAS MISSED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2001</td>
<td>$0.27</td>
<td>$0.26</td>
<td>$0.13</td>
<td>50%</td>
</tr>
<tr>
<td>Q2 2001</td>
<td>0.28</td>
<td>0.27</td>
<td>0.18</td>
<td>33%</td>
</tr>
<tr>
<td>Q3 2001</td>
<td>0.29</td>
<td>0.28</td>
<td>0.19</td>
<td>32%</td>
</tr>
<tr>
<td>Q4 2001</td>
<td>0.37</td>
<td>0.36</td>
<td>0.03</td>
<td>92%</td>
</tr>
<tr>
<td>FY 2001</td>
<td>1.21</td>
<td>1.20</td>
<td>0.50</td>
<td>58%</td>
</tr>
<tr>
<td>Q1 2002</td>
<td>0.40</td>
<td>0.40</td>
<td>0.46</td>
<td>-15%</td>
</tr>
<tr>
<td>Q2 2002</td>
<td>0.40</td>
<td>0.40</td>
<td>0.28</td>
<td>30%</td>
</tr>
<tr>
<td>Q3 2002</td>
<td>0.39</td>
<td>0.39</td>
<td>0.31</td>
<td>21%</td>
</tr>
</tbody>
</table>

6. The Individual Defendants' knowledge of the falsity of AFC's financial results is amply demonstrated by the magnitude of restatement, the length of the laundry list of items requiring restatement, the simplicity of the accounting violations and the timing of AFC insiders' stock sales, including those by

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1 Diluted EPS excluding losses from change in accounting principle and extraordinary losses on early extinguishment of debt.

2 Q3 2002 Actual & Consensus EPS figures exclude charges for the write down of inventory and leasehold improvements at the Seattle Coffee Company division.
transacted by certain Defendants. *AFC insiders, including certain Defendants, collectively sold over 9.2 million shares of AFC stock during the Class Period for proceeds of approximately $210 million.*

7. These stock sales were suspicious in both timing and amount. Defendant Pennington, for example, while serving as a director and a member of AFC’s audit committee, finished liquidating **100% of his AFC holdings** on November 22, 2002 — for proceeds of over $35 million -- shortly before AFC announced its need to restate its financial results for FY 2001 and FY 2002 on March 24, 2003, and only weeks after Defendant Belatti assured investors that there would be “no other accounting issues at AFC.” ¶ 122. Indeed, CWI\(^3\) stated that Defendants had “always intended to cash out their stock in AFC’s secondary public offering,” conducted in December 2001.

8. In the context of the post-Enron, post-Worldcom era’s alarming surge in corporate malfeasance and securities fraud scandals costing shareholders trillions of dollars in damages, Congress enacted the Sarbanes Oxley Act of 2002

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\(^3\) Statements obtained from seven former employees have been incorporated into this Complaint. In order to protect the confidentiality of these former employees, they are identified as “CW” (confidential witness), and their names have been omitted. They have been identified in accordance with this Court’s opinion in *In re Theragenics Corp. Sec. Litig.*, 137 F. Supp. 2d 1339 (N.D. Ga. April 2, 2001). An identification of the positions held by these employees is attached as Exhibit A.
("Sarbanes Oxley"). Under Section 906 of Sarbanes Oxley, the CEO and the CFO of publicly reporting companies are required to certify the accuracy and truthfulness of financial statements filed with the SEC. Defendants Wilkins and Belatti both signed Sarbanes Oxley 906 certifications for AFC’s 3rd quarter 2002 Form 10-Q filed with the SEC on November 20, 2002, personally affirming the veracity of the information included in those reports. Wilkins and Belatti signed those certifications even though they knew, or were severely reckless in not knowing, that the financial statements were materially false and misleading as evidenced by the restatement.

9. Defendants’ fraud came to an abrupt halt on March 24, 2003 upon AFC’s announced need for the restatement and its expectation that the Company would miss the March 31, 2002 deadline for filing its 2002 Annual Report. On March 25, 2003, AFC’s stock price dropped $3.70 or 21% on unusually high trading volume of over 9 million shares, closing at a new 52 week low of $13.40 per share, in contrast to AFC’s average daily trading volume of 300,000 shares.

10. In sharp contrast to Defendant Belatti’s earlier made public statements in AFC’s 2001 Annual Report that AFC was founded “…with the radical notion of being trustworthy,” and his subsequent representation during an August 13, 2002

4 Unless otherwise indicated, emphasis is supplied.
conference call that he had “great confidence in the transparency of [AFC’s] ...financial statements,” it became immediately apparent that his and the other Defendants’ actions spoke louder than their words. Salomon Smith Barney analyst Mark Kalinowski called the restatement announcement a “bombshell” in a report to investors, and withdrew his 2003 earnings and target price until the restatements were clarified.

11. Similarly, Morgan Stanley Investment Manager Richard Glass stated during a March 24, 2003 conference call that: “[t]here has to be some accountability in the company and changes need to be made if management is at all ... interested in regaining any credibility in the financial community. Because right now its got to be zero – or below zero.”

12. Even AFC’s own investment bankers -- namely, Defendant Credit Suisse First Boston Corporation -- acknowledged the damage to AFC’s credibility as a result of this unexpected disclosure. On April 3, 2003, securities analysts John S. Glass and Jeffrey D. Farmer of Defendant Credit Suisse First Boston Corporation stated in a report on the Company that it would “…take a considerable amount of time before the company rebuilds shareholder credibility.”
13. AFC employees responded to the “bombshell” no differently. In an article appearing in the December 22, 2003 edition of The Delaney Report, titled Fried, it was reported that “. . . sources say that Frank [Belatti] now has lost credibility among the AFC troops.”


15. On April 30, 2003, the Securities and Exchange Commission (“SEC”) commenced an inquiry into AFC, requesting production of documents and other information relating to AFC’s restatement. The SEC is also investigating whether certain disclosures made by AFC were compliant with SEC regulations.

16. AFC was delisted from NADAQ on August 18, 2003, forced to trade on the “pink sheets.”

II. JURISDICTION AND VENUE

17. This Court has jurisdiction over the subject matter of this action pursuant to §27 of the Exchange Act (15 U.S.C. §78aa) and 28 U.S.C. §1331. The claims asserted herein arise under Sections 11 and 15 of the Securities Act, 15 U.S.C. §§77k and 77o, and Sections 10(b), 20(a), and 20A of the Exchange Act, 15 U.S.C. §§78j(b) and 78t(a), and the rules and regulations promulgated thereunder
by the SEC, including Rule 10b-5, 17 C.F.R. §240.10b-5; and Section 304 of Sarbanes Oxley, 15 U.S.C. §7243.

18. Venue is proper in this District pursuant to Section 22 of the Securities Act and Section 27 of the Exchange Act, 28 U.S.C. §1391(b). Many of the acts and transactions giving rise to the violations of law complained of herein, including the preparation and dissemination to the investing public of false and misleading information, occurred in this District. In addition, AFC maintains its principal executive offices in this Judicial District.

19. In connection with the acts, conduct and other wrongs complained of herein, Defendants used the means and instrumentalities of interstate commerce, including the mails, telephone communications and the facilities of national securities exchanges.

III. THE PARTIES

A. LEAD PLAINTIFFS

20. The International Union of Operating Engineers Local 132 Pension Plan ("Local 132"), Thomas Savchick and the Perkins Family Trust were appointed by the Court on August 18, 2003 to serve as Lead Plaintiffs in this class action.
21. Lead Plaintiff Local 132 purchased AFC common stock, some of which was purchased contemporaneously with the sale of AFC common stock by one or more of the Defendants named in ¶ 247 below in violation of § 20A of the 1934 Act, as detailed in its certification, and suffered substantial damages thereby.

22. Lead Plaintiff Thomas Savchick purchased stock pursuant to AFC's initial offering of common stock on March 2, 2001 ("Initial Public Offering" or "IPO"), and suffered substantial damages thereby.

23. Lead Plaintiff Perkins Family Trust purchased AFC common stock and suffered substantial damages thereby.

B. DEFENDANTS

24. Defendant AFC is organized under the laws of Minnesota and maintains its principal executive offices at Six Concourse Parkway, Suite 1700, Atlanta, Georgia. As set forth above, during the Class Period, AFC operated, developed and franchised quick service restaurants, bakeries and cafés under various trade names. Collectively, AFC comprises over 4,000 restaurants nationwide.

25. AFC's Board of Directors used working committees to oversee and control AFC's business. These committees met frequently and received detailed written and oral reports concerning those parts of AFC's business within their
purview. They were: (a) the Audit Committee, which worked with AFC’s auditors, as well as AFC officers and employees who were responsible for legal, financial and accounting matters. It approved the appointment of Arthur Andersen as AFC’s “independent” auditor and the Audit Committee reviewed and approved the accounting policies and reporting practices, internal auditing and internal controls, and compliance with AFC’s policies regarding business conduct (see also ¶ 40, 222-23); (b) the Executive Committee; (c) the Strategic Development Committee; and (d) the People Services (Compensation) Committee.

26. In addition to these committee meetings, AFC senior management conducted regular meetings in which the financial results and condition of the Company were discussed. According to CW5, AFC conducted a number of meetings including Periodic P&L meetings, Quarterly Business Meetings and Annual Business Planning Sessions. The Periodic P&L meetings took place every four weeks at AFC headquarters, and were attended by Holbrook and Wilkins, as well as other senior management from Popeyes and Church’s and the other divisions.
1. **The Individual Defendants**

(a) Frank Belatti

27. Defendant Frank Belatti, at all times relevant to this action, served as Chairman of the Board of AFC, its Chief Executive Officer ("CEO"), and was its interim Chief Financial Officer ("CFO") until January 5, 2004. He chairs the Executive Committee, which is empowered to act on behalf of the Board, and is a member of the Strategic Development Committee, and attended regular meetings at AFC, including the Quarterly Business Meeting. Belatti was a signatory to the Registration Statements and Prospectuses ("Prospectuses") filed with the SEC in connection with the Company's two public offerings, signed the 2000, 2001 and 2002 10-Ks, and certified the second and third quarter 10-Qs and the 10-K for 2002.

28. During the Class Period, while in possession of adverse undisclosed information about AFC's financial fraud, Belatti sold 438,000 shares – or nearly 20% of his AFC stock -- for $10,682,736.50 in insider trading proceeds. Belatti also received total performance-based bonus payments of over $997,062 during the Class Period. See ¶¶ 229-30. The unusual nature of this Defendant's insider selling is shown below:
29. Indeed, even after Belatti announced a share repurchase program on July 22, 2002 because he stated AFC was “undervalued,” Belatti sold 43,000 shares through the exercise of options.

(b) Gerald Wilkins

30. Defendant Gerald J. Wilkins, served as Chief Financial Officer of AFC since December 1995 and as Executive Vice-President since December 2000. Wilkins is a seasoned financial professional with significant accounting, auditing and SEC reporting experience. Wilkins was trained and employed as a Certified Public Accountant with an MBA from Stanford and worked as an accountant at a
“Big Six” accounting firm prior to joining AFC. In May 2001, Wilkins was named a Director of the Company.

31. Wilkins, as AFC’s top financial officer, was an extremely hands-on manager. According to CW3, Wilkins and Holbrook were the “two guys that made decisions” and who “were always concerned with the stock price.” Wilkins signed the Prospectuses in connection with both of AFC’s public offerings, as well as all the 10-Qs and 10-Ks between March 2, 2001 and December 15, 2003, including certifying the second and third quarter 10-Qs and 10-K for 2002. On April 29, 2003, one month after AFC’s announcement of an enormous financial restatement, Wilkins resigned from the Company to “pursue other interests.”

32. During the Class Period, while in possession of adverse undisclosed information about AFC’s accounting, Wilkins sold 109,000 AFC stocks and options, 46.67% of his holdings, for over $2,921,475 in insider trading proceeds. Wilkins also received total performance-based bonus payments of over $550,000 during the Class Period. ¶¶ 229-30. The unusual nature of this Defendant’s insider selling is shown below:
33. In addition to being primarily responsible for AFC's overall financial reporting, Wilkins was directly involved in AFC's "conversions." Wilkins signed off on all the conversion deals at AFC. A conversion refers to the sale of company-owned restaurants, bakery or café units to franchisees. The Company's improper recognition of gains on these conversions comprised one of the largest categories of restated items. According to CW4, the accounting for the conversion process "was all up to Gerald Wilkins." Indeed, as detailed further below in ¶¶ 159-64, Wilkins directly approved the improper conversion deals at AFC and was
the driving force behind the whole conversion program to “make the company’s earnings look better.”

(c) Dick Holbrook

34. Defendant Dick R. Holbrook served as President and Chief Operating Officer of AFC since 1995. Holbrook signed the Prospectuses in connection with both of AFC’s public offerings. He was named Director of the Company and a member of the Strategic Development Committee in May 2001. The Strategic Development Committee is responsible for recommendations to the Board of Directors with respect to strategic plans, including potential mergers and acquisitions, as well as financing alternatives. Holbrook, Wilkins and Belatti all received “Brand Review Books” on at least a quarterly basis. According to CW1, this book contained profit and loss statements, comparable sales and conversion reporting for each AFC brand, including the gains attributable to each deal.

35. During the Class Period, while in possession of adverse undisclosed information about AFC’s financial fraud, Holbrook sold 311,740 shares – or over 30% of his AFC stock – for $7,898,346.99 in insider trading proceeds. Holbrook also received total performance-based bonus payments of over $800,000 during the Class Period. ¶ 229. The unusual nature of this Defendant’s insider selling is shown below:
2. **The Director Defendants**

36. Defendant Samuel N. Frankel served as Executive Vice President, Secretary and General Counsel of AFC at all times material hereto. He also served as a Director of the Company from 1992 to February 2001. Frankel signed the Registration Statements and Prospectus filed in connection with the IPO.

37. Defendant Mark J. Doran, has served as a director of AFC since April 1996 and has continued to serve in that capacity at all times material hereto. Doran joined Freeman Spogli & Co. ("Freeman Spogli") in 1988 and became a general
partner of Freeman Spogli in 1998. Doran signed the Prospectus filed with the SEC in connection with the IPO.

38. Defendant Paul Farrar served as Director of the Company at all times material hereto and signed the Prospectus filed with the SEC in connection with the IPO.

39. Defendant William M. Wardlaw served as Director of the Company at all times material hereto. Wardlaw joined Freeman Spogli in 1988 and became a general partner in 1991. Wardlaw signed the Prospectus filed with the SEC in connection with the IPO.

40. Defendant Matt L. Figel has served as a Director of the Company since April 1996 and continued to serve in that capacity at all times material hereto. Figel also served on AFC's Audit Committee, which is responsible for recommending to the Board of Directors the appointment of independent auditors, analyzing the reports and recommendations of the auditors and reviewing internal audit procedures and controls. From October 1986 to December 1996, Figel was employed by Freeman Spogli. Figel signed the Prospectuses filed with the SEC in connection with both AFC public offerings.

41. Defendant Peter Starrett has served as a Director of AFC since September 1998 and has continued to serve in that capacity at all times material
Defendant Starrett signed the Prospectuses for both AFC public offerings.

3. **Defendants Freeman Spogli and the Penman Defendants**

42. Defendant Freeman Spogli is a privately owned investment firm located at 11100 Santa Monica Boulevard, Suite 1900, Los Angeles, California, 90025. Defendants Doran, Wardlaw, Roth and Spogli were all general partners of Freeman Spogli at the time of AFC’s Initial Public Offering and Defendant Figel was an employee of Freeman Spogli from October 1986 to December 1996. Through its various limited and/or general partners, Freeman Spogli is AFC’s largest shareholder. According to AFC’s Form S-1 Registration Statement filed as part of its March 2, 2001 IPO, 6 of the 11 directors of AFC were representatives of Freeman Spogli immediately after that offering. Freeman Spogli also represented the controlling majority of AFC’s Executive Committee, which was empowered to act on behalf of the Board. According to AFC’s 2002 Proxy Statement, Roth and Spogli are deemed to be the beneficial owners of AFC stock held by Freeman Spogli including FS Equity Partners III, FS Equity Partners International and FS Equity Partners IV.

43. Defendant John M. Roth has served as a Director of AFC since April 1996 and has continued to serve in that capacity at all times material hereto. Roth served on the Executive Committee and the People Services Committee. Roth
joined Freeman Spogli in March 1988 and became a general partner in 1993. Roth signed the Registration Statements and Prospectuses in connection with both AFC offerings.

44. Defendant Ronald P. Spogli has served as a Director of AFC since April 1996. Spogli also serves on the Advisory Board of the Penman Fund. He is a member of AFC’s Executive Committee, which is empowered to act on behalf of the Board of Directors. Spogli signed the Registration Statements and Prospectuses in connection with both of AFC’s public offerings. Defendant Spogli is a founding principal of Freeman Spogli. Spogli, through Freeman Spogli, sold over 6.6 million shares of AFC stock, representing approximately 46.84% of Freeman Spogli’s total AFC holdings, for over $152 million during the Class Period, as shown below:
45. Penman Asset Management L.P. ("Penman Asset") is a privately owned investment firm located at 30 North Lasalle Street, Suite 1620, Chicago, Illinois, 60602. Through PENMAN Private Equity and Mezzanine Fund, L.P., Penman Asset was a controlling shareholder of AFC during the relevant period.

46. Defendant Kelvin Pennington has served as a Director of AFC since May 1996, and signed the Prospectuses in connection with both of AFC public offerings. He is a member of AFC’s Audit Committee and the People Services Committee. According to AFC’s April 2002 Proxy Statement, the People Services Committee is responsible for reviewing and recommending the compensation.
programs structure for officers and directors, including salaries, participation in
incentive compensation, benefit and stock option plans, and other forms of
compensation. Since 1992, Pennington has served as the General Partner of
Penman Asset, which in turn is the General Partner of PENMAN Private Equity
and Mezzanine Fund, L.P. ("PENMAN").

47. During the Class Period, Pennington, through PENMAN, sold 100% of his shares - - 1,574,637 shares and options for a total of more than $35 million.
The unusual nature of this Defendant's insider selling is shown below:

\[\text{In addition to serving on the Audit Committee, Pennington also controls the corporation called Pennington P.C., which serves as general partner of Penman Partners (the management company of Penman). According to its own website, Pennington P.C. claims to "remain actively involved in companies it invests in," and "actively monitors the performance of its portfolio companies through dialogue with senior management and monthly and/or quarterly financial review of operating performance."}\]
4. The Underwriter Defendants

48. Defendants Goldman, Sachs & Co., Credit Suisse First Boston Corporation and Deutsche Banc Alex. Brown, collectively referred to as "Underwriter Defendants," provided underwriting services for the initial and secondary public offerings of AFC's common stock. As a result of the IPO, Goldman, Sachs & Co., Credit Suisse First Boston Corporation, and Deutsche Banc Alex. Brown shared in the $11,156,250 in underwriter fees generated by the Initial Public Offering.
IV. CLAIMS AGAINST DEFENDANTS RELATED TO AFC’S PUBLIC OFFERINGS

A. BACKGROUND

49. As set forth above, during the Class Period, AFC conducted two public offerings. The Initial Public Offering commenced on March 2, 2001 and the Secondary Offering commenced on December 6, 2001.

50. Prior to AFC’s IPO, AFC issued Freeman Spogli, PENMAN and Belatti 14 million shares, 1.6 million shares, and 2.2 million shares of AFC stock respectively. Those Defendants additionally took millions of dollars in long-term “loans” to pay the purchase price and/or the stock option exercise price that was collateralized by the stock issued. Such loans enabled them to purchase AFC stock at approximately $11 per share or lower and also had provisions allowing them to repay the loans with Company stock in the IPO.

51. The Prospectuses issued by AFC for both its IPO and its Secondary Offering contained financial statements that were, by AFC’s own admission, materially false and misleading as revealed by the Company’s restatement of financial results for 1998, 1999, 2000, 2001 and the first three quarters of 2002.

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6 This was a considerable discount relative to the price of AFC’s stock later issued in the IPO at $17.00 per share.
52. AFC’s financial statements were false because the Company: (a) improperly failed to defer gains associated with restaurant sales to franchisees; (b) improperly understated current expenses by various means (including improper deferral of expenses, improper capitalization of expenses and overstatement of depreciable asset lives, among others); (c) failed to write down impaired assets; (d) improperly overstated inventory; (e) improperly understated accrued liabilities; (f) improperly capitalized interest on completed construction projects; (g) improperly accounted for rebates; (h) improperly reduced certain lease expenses by first subtracting fictitious sublease rental income; (i) failed to consolidate and include Popeye’s and Church’s advertising funds and expenses in AFC’s financial statements; and (j) failed to record accruals accurately.

B. AFC’S PROSPECTUS FOR THE IPO WAS MATERIALLY FALSE AND MISLEADING

53. On March 2, 2001, AFC filed and the SEC declared effective, AFC’s Prospectus and Registration Statement dated March 2, 2001 in connection with the Company’s IPO of 10,781,250 shares at a price of $17.00. Defendants Belatti, Wilkins, Holbrook, Doran, Farrar, Wardlaw, Figel, Pennington, Roth, Spogli, and Starrett signed the Registration Statement. The Offering, which was underwritten by Underwriters Goldman Sachs, Credit Cuisse First Boston and Deutsche Bank Alex. Brown, was completed on March 7, 2001. A total of 3,136,328 shares were
sold by the Company and 7,644,922 shares were sold by certain selling shareholders.

54. The Prospectus included the following statements concerning long-lived assets:

Management periodically reviews the performance of restaurant, bakery, café and other long-lived assets. If it is determined that a restaurant, bakery or café will be closed, the carrying value of the property and equipment is adjusted to net realizable value. Property held for sale includes closed restaurant properties and other corporate property held for sale, and is recorded at its estimated net realizable value. It is the Company’s policy to evaluate (i) operating restaurant, bakery and café properties on a market basis, (ii) other assets, such as assets held for sale and income producing assets, on an individual property basis, and (iii) intangible assets raised on the cash flows from the underlying operations which generated the intangible asset. The identifiable cash flows of long-lived assets are compared to the asset’s carrying value.

55. These statements indicated that the Company was valuing AFC’s long-lived assets properly, accurately and in compliance with Generally Accepted Accounting Principles (“GAAP”). That indication was reinforced by the assurances of AFC’s auditors, Arthur Andersen – also published in AFC’s IPO Prospectus -- that the financial statements included therein for 1998, 1999 and 2000 were indeed prepared in accordance with GAAP.
56. The statements alleged in ¶¶ 54-55 above were misleading, however, because the Company was not properly valuing AFC’s long lived assets. As later revealed in AFC’s 2002 Form 10-K filed with the SEC on December 15, 2003:

**Impairment of Long-Lived Assets.** The Company’s prior accounting treatment regarding impairment of long-lived assets was to evaluate company-operated QSRs (Quick Service Restaurants) on a market basis. *The Company has determined that the evaluation should have been performed on a site by site basis which is the lowest level of identifiable cash flows as required by SFAS 121.* Accordingly, the Company adjusted its long lived asset impairment charges (including an adjustment to record $3.0 million and zero impairment of goodwill allocated to the individual units in 2001 and 2000, respectively) to reflect the evaluation on a site-by-site basis.

57. The March 2, 2001 Prospectus included AFC’s historical financial data, including the operating results from FY 1998 through FY 2000. As admitted by the Company in its restatement issued on December 15, 2003, and more specifically alleged in ¶¶ 147-218 below, those financial statements were false and materially misrepresented the Company’s actual financial position.

58. The table below, copied from the 2002 Form 10-K filed with the SEC on December 15, 2003, illustrates specifically the material impact of the restatement on the 2000 financials contained in the IPO Prospectus.
<table>
<thead>
<tr>
<th></th>
<th>2000</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>As Previously Reported</td>
<td>As Restated</td>
</tr>
<tr>
<td><strong>Revenues:</strong></td>
<td>(In millions)</td>
<td></td>
</tr>
<tr>
<td>Sales by company-operated restaurants</td>
<td>$567.4</td>
<td>$567.4</td>
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<tr>
<td>Franchise revenues</td>
<td>90.4</td>
<td>88.7</td>
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<td>Wholesale revenues</td>
<td>56.7</td>
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<td><strong>Expenses:</strong></td>
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<td>Impairment charge and Other</td>
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<td><strong>Total Expenses</strong></td>
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<tr>
<td>Extraordinary loss on debt extinguishments, net of taxes</td>
<td>0.2</td>
<td>---</td>
</tr>
<tr>
<td>Discontinued operations, net of Taxes</td>
<td>---</td>
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</tr>
</tbody>
</table>
59. In 2000, the Company had overstated its revenue by $2.0 million while understating its expenses by $12.3 million. Even more misleading to investors who purchased in the IPO was the Company’s grossly overstated operating profit of $81.6 million, which represented an overstatement of 21% over the actual $67.3 million profit. In addition:

(a) The Prospectus reported income of $47.7 million before taxes, an overstatement of 40% from the actual $34 million as restated;

(b) The Prospectus also overstated income from continuing operations by 51%, indicating that it was $27.7 million when it was actually $18.3 million;

(c) The 2000 annual net income reported in the Prospectus was overstated by 50% to $27.5 million, while the actual net income for 2000 was $18.3 million.

60. The IPO Prospectus also included false historical financial information for 1998 and 1999. The 1998 and 1999 financials, both of which were contained in the Prospectuses for the IPO and SPO, were materially false and misleading. In 1998, AFC’s reported net loss of $3.4 million understated its actual
net loss of $10.4 million by 67%, and in 1999 it overstated its actual net income of $9.8 million by 43% to $14.0 million.

C. AFC'S PROSPECTUS FOR THE SECONDARY OFFERING WAS MATERIALLY FALSE AND MISLEADING

61. On December 6, 2001, AFC conducted a Secondary Offering of 7,000,000 shares priced at $23 per share. The Prospectus for the Secondary Offering dated December 5, 2001, was filed with the SEC on December 6, 2001 and was signed by, inter alia, Defendants Belatti, Wilkins, Holbrook, Figel, Pennington, Roth, Spogli and Starrett. The SPO was underwritten by, inter alia, the Underwriter Defendants.

62. Incorporated into the SPO Prospectus were the Company’s financial results for FY 1998, 1999 and 2000 and the first three quarters of 2001, all of which were restated by the Company on December 15, 2003. As illustrated by the chart in ¶ 58 above, and more specifically alleged in ¶¶ 147-218 below, those reported financial results were materially misleading statements that caused the investing public to purchase AFC stock at an artificially inflated price. The SPO Prospectus also included AFC’s historical data for 1998 that was materially overstated, as detailed above in ¶¶ 57-58, 60.

63. Defendants also boldly asserted in the Secondary Offering Prospectus:
From 1996 to 2000, our management team engineered a dramatic improvement in our overall performance. From 1996 to 2000, we also increased total system-wide sales at a compound annual rate of 13.6%, franchising revenue at a compound annual rate of 15.4%, EBITDA at a compound annual rate of 18.3%, and EBITDA margin from 13.1% to 17.4%.

64. The “dramatic improvement” trumpeted by the Company in the SPO Prospectus was purely illusory and only achieved because of their far-reaching accounting misconduct. AFC’s accounting mirage would prove so vast – and time consuming to unravel -- that AFC’s newly engaged auditor, KPMG, was delayed in the filing of AFC’s 2002 Form 10-K until December 2003. That delay not only indicated the massive nature of the restatement, but also caused AFC’s stock to become delisted by Nasdaq.

**COUNT I**

AGAINST AFC, UNDERWRITER DEFENDANTS, BELATTI, WILKINS, HOLBROOK, FRANKEL, DORAN, FARRAR, WARDLAW, FIGEL, PENNINGTON, ROTH, SPOGLI, AND STARRETT PURSUANT TO SECTION 11 OF THE SECURITIES ACT

65. This Count is brought on behalf of persons who purchased AFC stock issued pursuant to or traceable to the March 2, 2001 offering.

66. Lead Plaintiff Tom Savchick, who purchased in the IPO, brings this Count and repeats and realleges each and every allegation contained in the above paragraphs, as if fully set forth herein. With respect to this Count, Lead Plaintiff
Savchick and the Class specifically exclude any allegations of knowledge or scienter.

67. The IPO Prospectus contained misrepresentations of material fact and omitted to state material facts required to be stated in order to make the statements contained therein not misleading. As such, these Defendants are liable to Plaintiffs and the Class.

68. These Defendants issued, caused to be issued and participated in the issuance of materially false and misleading statements to the investing public that were contained in the IPO Prospectus. As a direct and proximate result of these Defendants’ wrongful conduct, the market price for AFC stock sold pursuant to or traceable to the Prospectus was artificially inflated, and Lead Plaintiff Savchick and the Class suffered substantial damages in connection with their purchase of the AFC stock in the IPO.

69. This action was initiated within three years after the AFC stock was sold to the public under the IPO and within ten months from the time the truthfulness of the Prospectus was called into question.

70. Lead Plaintiff Savchick and other class members were damaged by these Defendants’ misconduct and by the material misstatements and omissions of the aforementioned Prospectus.
71. These Defendants utilized national securities exchanges, the mails, telephones and other instruments of interstate commerce in the offering and sale of the AFC stock.

COUNT II
AGAINST DEFENDANTS BELATTI, WILKINS, HOLBROOK, FRANKEL, DORAN, FARRAR, WARDLAW, FIGEL, PENNINGTON, ROTH, SPOGLI, STARRETT AND FREEMAN SPOGLI PURSUANT TO SECTION 15 OF THE SECURITIES ACT IN CONNECTION WITH AFC’S IPO

72. Defendants Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Samuel N. Frankel, Mark Doran, Paul Farrar, William M. Wardlaw, Matt L. Figel, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Peter Starrett and Freeman Spogli were controlling persons of AFC within the meaning of Section 15 of the Securities Act by reason of their respective management positions in AFC, and/or their membership on AFC’s Board of Directors, and/or their stock ownership, and/or their participation throughout the Class Period in the day-to-day affairs of AFC. Because of their positions in the Company and/or their stock ownership, and/or because of their positions on the AFC Board of Directors, these Defendants had the requisite power to directly or indirectly control or influence the specific corporate policy that resulted in the unlawful acts and conduct alleged pursuant to Count I.
73. By reason of the foregoing, Defendants Frank Belatti, Gerald J.
Wilkins, Dick R. Holbrook, Samuel N. Frankel, Mark Doran, Paul Farrar, William
M. Wardlaw, Matt L. Figel, Kelvin Pennington, John M. Roth, Ronald P. Spogli,
Peter Starrett and Freeman Spogli have violated Section 15 of the Securities Act.

V. CLAIMS AGAINST DEFENDANTS UNDER SECTION 10(b) OF
THE EXCHANGE ACT

A. FALSE AND MISLEADING STATEMENTS

1. Defendants' False 1Q01 Public Statements

74. On May 21, 2001, Defendants reported AFC's first quarter 2001
financial results through a press release entitled, "AFC Enterprises, Inc. Reports
First Quarter 2001 Earnings Per Share of $0.27, Up 50 Percent." The press
release stated:

Net income from continuing operations increased 57 percent to $8.0
million compared with $5.1 million in the first quarter 2000, well
ahead of AFC's long-term growth goal of 25 percent. Diluted
earnings per share of $.27 for the first quarter 2001 increased 50
percent compared with $.18 for the first quarter 2000.

75. AFC filed its first quarter 2001 Form 10-Q on the same day, May 21,
2001. The first quarter 2001 Form 10-Q was signed by Defendant Wilkins and

7 The Prospectuses filed in connection with the IPO and SPO detailed above
comprise additional materially false statements that are also actionable as false
statements under the Exchange Act. The reasons for the falsity of these
Prospectuses are detailed in ¶¶ 56, 147-218.
repeated the financial results reported in AFC’s May 21, 2001 press release. 8

2. Reasons Why the 1Q01 Press Release and 10-Q Were False

76. AFC’s reported first quarter 2001 financial results contained in both the May 21, 2001 press release and the first quarter 2001 Form 10-Q were false and misleading for the reasons more specifically alleged in ¶¶ 147-218 below.

77. While the May 21, 2001 press release boasts that AFC’s reported net income from continuing operations was “well ahead” of AFC’s long-term growth goal of 25 percent, AFC and the Individual Defendants knew or were severely reckless in not knowing that the Company’s reported net income was materially overstated as reflected by the 2001 restatement in which they later made a downward adjustment of net income from $36.9 million to $15.6 million, reflecting an overstatement for FY 2001 of 136.5% over actual net income.

78. In addition, although AFC claimed its earnings per share to be $.27 -- beating securities analysts’ consensus forecast of by a penny, and representing a 50% increase over the earnings per share (“EPS”) for the first quarter of 2000 -- Defendants knew or were severely reckless in not knowing that AFC’s actual EPS

8 Each of the Form 10-Qs filed by AFC during the Class Period contained the following false statement: “The accompanying condensed consolidated financial statements...in the opinion of management contain all adjustments (which are of a normal recurring nature) necessary for a fair presentation of the Company’s financial condition and results of operations for the interim periods presented.”
was only $.13. Thus, this actually represented a 27% decrease from AFC’s $.18 EPS from the comparable period the prior year.

3. Defendants’ False Statements Continue During 2Q01

79. On August 14, 2001, the Company issued a press release announcing AFC’s financial results for the second quarter of fiscal year 2001, ended July 15, 2001. The headline of the press release was, “AFC Enterprises, Inc. Reports Second Quarter 2001 Earnings Per Share From Continuing Operations of $0.28, Up 40 Percent.” The Company reported the following financial highlights:

Second quarter of 2001 vs. second quarter of 2000 highlights include:

- Net income from continuing operations increased 53.7 percent to $9.0 million
- Diluted EPS from continuing operations increased 40 percent to $0.28
- Operating EBITDA margin increased 150 basis points to 18.6 percent
- System-wide sales increased 8.8 percent to $594.1 million
- Franchise revenues increased 23.1 percent
- Wholesale revenues increased 18.9 percent
- The AFC system added 338 new commitments, opened 96 new restaurants, bakeries and cafes, three imaged over 50 additional restaurants and bakeries, and completed 37 conversions of company-owned units to franchised units.
80. Defendant Belatti was quoted as saying:

We are extremely pleased to report AFC’s results for the second quarter of 2001. On a comparable quarterly basis, both system sales and our operating margins reflect record level performance.

81. Furthermore, Holbrook stated in the August 14, 2001 press release that

Popeye’s Chicken & Biscuits, Church’s Chicken and Cinnabon all had slight to above average positive comparable sales domestically for the quarter, and Seattle Coffee Company which was flat, had a health increase in their wholesale revenue. More importantly, our operating margins are holding up despite a variety of cost pressures on the business. We continue to aggressively strive to deliver strong operating margins and focus on the growth elements of the business.

82. These results were repeated in AFC’s second quarter Form 10-Q, for period ended July 15, 2001, filed with the SEC on August 13, 2001, and signed by Defendant Wilkins.

4. Defendants’ 2001 Public Statements Were False

83. The “record level” financial results published in AFC’s August 14, 2001 press release and its second quarter 2001 Form 10-Q were false and misleading for the reasons more specifically alleged in ¶¶ 147-218 below. AFC’s headlined 40% increase over the second quarter EPS of 2000, beat securities analysts’ consensus forecast by a penny. However, as later revealed by AFC’s
restatement, its second quarter 2001 EPS was actually only $0.18, or 33% less than the forecast.

84. Similarly, AFC’s reported net income of $9 million, representing an increase of 53.7%, was materially overstated as revealed by AFC’s restatement that provided for a downward adjustment to net income for 2001 from $36.9 million to $15.6 million. Thus, AFC’s actual net income for 2001 had been overstated by 136%.

5. Defendants Issue False Statements During 3Q01 In Order to Maximise Their “Cash-Out” in the SPO


Third quarter of 2001 vs. third quarter of 2000 highlights include:

- Diluted EPS from continuing operations increased 26 percent (as adjusted) to $0.29;
- Net income from continuing operations increased 42 percent (as adjusted) to $9.1 million;
- Net income margin increased 180 basis points (as adjusted) to 5.7 percent;
• Operating EBIDTA margin increased 90 basis points (as adjusted) to 18.6 percent in line system-wide sales increased 8.7 percent to $607 million;

• Franchise revenues increased 17 percent;

• Wholesale revenues increased 11 percent;

• Total domestic comparable sales increased 4 percent; and

• The net gain on sale of assets of $2.9 million in the third quarter was primarily due to the sale of 13 Church’s company-operated restaurants to franchisees and 10 Cinnabon company-operated bakeries to franchisees.

86. In the November 13, 2001 press release, Belatti stated:

I’m pleased to report on another quarter of exceptional performance... AFC continues to demonstrate its ability to consistently deliver positive results... including its stated goal of 25 percent or greater EPS growth. Our ability to deliver on our EPS growth rate target is a function of how well we’ve executed our strategic business model – including franchising, our conversion strategy and the move to model markets and wholesaling.

6. Defendants’ 3Q01 Statements Were Materially False

87. On November 14, 2001, the Company filed its 10-Q for the third quarter of fiscal year 2001, which repeated the financial results detailed above.

The Form 10-Q for the third quarter of 2001 was signed by Defendant Wilkins.

88. Defendants knew or were severely reckless in not knowing that the financial results published in both the November 13, 2001 press release, and AFC’s third quarter Form 10-Q were materially false and misleading for the
reasons more specifically alleged in ¶ 147-218 below. AFC’s purported EPS of $0.29 beat securities analysts’ consensus by a single penny. However, as revealed through AFC’s restatement, its actual EPS for the third quarter of 2001 was only $0.19, or 32% below that consensus. In addition, AFC’s reported net income of $9.1 million – a purported 42% increase – was also overstated, as revealed by AFC’s restated net income for FY 2001 from $36.9 million to $15.6 million.

89. Belatti’s statements in the press release detailed in ¶ 86 were false and misleading, particularly the statement that AFC’s “conversion strategy” was a contributing factor to “greater EPS growth.” As alleged in ¶¶ 142, 151-64 below, AFC’s “gains associated with unit conversions” represented the single largest restated component of the twenty-one item laundry list categories in the Company’s FY 2001 restatement.

90. AFC filed a registration statement and Prospectus with the SEC on December 6, 2001 in connection with its SPO. The Prospectus was signed by Defendants Belatti, Pennington and Holbrook (among other Defendants). According to CW1, “the [Individual] Defendants always intended to cash out in the secondary public offering.” Indeed, none of the proceeds from the offering went to
the Company. They all went to Defendants and other insiders. The following

Defendants sold stock in the SPO:

<table>
<thead>
<tr>
<th></th>
<th>Shares Sold</th>
<th>Proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freeman Spogli</td>
<td>6,624,000</td>
<td>$152,352,000.00</td>
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<tr>
<td>Penman Private Equity</td>
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<tr>
<td>Belatti</td>
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<tr>
<td>Holbrook</td>
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<td>Frankel</td>
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<td><strong>TOTALS</strong>:</td>
<td><strong>8,050,000</strong></td>
<td><strong>$198,648,991.05</strong></td>
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</table>

91. Defendants Pennington, Holbrook and Belatti who collectively received proceeds of approximately $46,026,991.05 were motivated to artificially inflate the price of AFC’s stock to maximize their return from the SPO. AFC’s stock price in the SPO was artificially inflated because the Prospectus and Registration Statement contained false and misleading financial statements for FY 1998 through FY 2000 as alleged in ¶¶ 52, 56, 58-60 above and ¶¶ 147-218 below.

7. **AFC’s False 2001 Year-End Results**

92. On February 20, 2002, Defendants issued a press release announcing financial results for the fourth quarter and year end 2001. The title of the press release was, **AFC Enterprises, Inc. Reports 2001 Annual Earnings Per Share From Continuing Operations of $1.21, up 25 Percent.** The press release stated:

FY2001 (52 weeks) vs. FY2000 (53 weeks) highlights include:

---

9 The Secondary Offering as completed totaled 8,050,000 shares instead of 7 million due to an over-allotment of shares.
Diluted earnings per share from continuing operations increased 25 percent to $1.21;

Franchise revenues increased 18 percent;

Wholesale revenues increased 14 percent;

Total domestic comparable sales increased 3 percent;

Worldwide unit openings growth of 19 percent;

Operating EBIDTA margin increased 100 basis points to 18.4 percent;

Net income margin from continuing operations increased 170 basis points to 5.5 percent; and

Net income from continuing operations increased 37 percent to $37.9 million;

Fourth quarter of 2001 (12 weeks) vs. fourth quarter of 2000 (13 weeks) highlights include:

Diluted EPS from continuing operations increased 16 percent $0.37;

Franchise revenues increased 18 percent;

Wholesale revenues increased 7 percent;

Total domestic comparable sales increased 3 percent;

Operating EBIDTA margin increased 100 basis points to 20.3 percent;

Net income margin from continuing operations increased 220 basis points to 7.3 percent; and

Net income from continuing operations increased 27 percent to $11.8 million.

93. Commenting on the results, Defendant Belatti stated:
AFC reached a number of milestones this year and we are extremely proud of these accomplishments. We delivered on our promise of a 25 percent diluted EPS growth rate. We successfully completed both an IPO and a secondary offering. We also opened 429 new restaurants, bakeries, and cafes system-wide, more than in any single year of our history, had record franchise revenues, and record 18.4 percent operating EBIDTA margin and achieved a record 5.5 percent net income margin from continuing operations. We look forward to the coming year as we continue to build on the exceptionally solid foundation we've established.

94. That same day, AFC filed its 2001 annual report with the SEC on Form 10-K (the “2001 10-K”), which was signed by Defendants Belatti, Wilkins, Holbrook, Figel, Pennington, Roth, Spogli and Starrett. The 2001 10-K reiterated the revenue and earnings figures as set forth in the February 20, 2002 press release. Additionally, the 2001 10-K stated that the net gain on sale of assets of $73 million in 2001 was primarily due to the sale of 71 Church’s company-operated restaurants, 27 Popeye’s company-operated restaurants and 36 Cinnabon company-operated bakeries to franchisees.

8. Defendants’ 4Q and Year-end 2001 Financial Results Were Dramatically Overstated

95. AFC’s fourth quarter and year end 2001 financial results alleged in ¶¶ 92-94 above were false and misleading for the reasons more specifically alleged in ¶¶ 147-218 below and as evidenced by AFC’s restatement of those results revealed in AFC’s December 15, 2003 10-K for FY 2002 as follows:
<table>
<thead>
<tr>
<th></th>
<th>2001 As Previously Reported</th>
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<td><strong>Total Revenues</strong></td>
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<td><strong>Expenses:</strong></td>
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<td>147.1</td>
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<td>General and administrative Expenses</td>
<td>108.0</td>
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<td>Wholesale cost of sales and operating expenses</td>
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<td>41.3</td>
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<tr>
<td><strong>Total Expenses</strong></td>
<td><strong>606.8</strong></td>
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<td>Operating profit</td>
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<td>Extraordinary loss on debt extinguishments, net of taxes</td>
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<tr>
<td>Discontinued operations, net of Taxes</td>
<td>----</td>
<td>----</td>
</tr>
</tbody>
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96. In 2001, the Company had overestimated its revenue by $5.4 million while understating its expenses by $26.5 million. Even more misleading to the investing public was the Company’s grossly overstated operating profit of $85.8 million, which represents an overstatement of 40% over the actual $53.9 million profit. In addition:

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(b) AFC overstated income before taxes by 113%, from the actual $29.3 million to $62.6 million;

(c) AFC also overstated income from continuing operations by 142%, indicating that it was $37.9 million when it was actually $15.6 million; and

(d) Even with the $11 million reduction in tax expenses, the actual 2001 net income was overstated by 136% to $36.9 million while the actual net income for 2001 was $15.6 million.

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<td>(0.7)</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>(0.9)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Business taxes and related professional fees</td>
<td>(0.9)</td>
<td>0.2</td>
</tr>
<tr>
<td>Slotting fees at Seattle Coffee</td>
<td>(0.9)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Beverage rebates</td>
<td>(0.8)</td>
<td>0.3</td>
</tr>
<tr>
<td>Rent expense</td>
<td>(0.8)</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Sales allowances at Seattle Coffee</td>
<td>(0.6)</td>
<td>(0.2)</td>
</tr>
<tr>
<td>Recognition of re-imaging costs</td>
<td>(0.6)</td>
<td>0.3</td>
</tr>
<tr>
<td>Future lease obligations – closed units</td>
<td>0.8</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Advertising funds</td>
<td>(0.4)</td>
<td>(0.3)</td>
</tr>
<tr>
<td>Leasehold improvements – useful lives</td>
<td>(0.3)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Legal accrual</td>
<td>---</td>
<td>1.5</td>
</tr>
<tr>
<td>Capitalized expenses</td>
<td>---</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Workers’ compensation accrual</td>
<td>---</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Group medical insurance accrual</td>
<td>---</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Other</td>
<td>0.3</td>
<td>0.1</td>
</tr>
<tr>
<td>Subtotal</td>
<td>(31.6)</td>
<td>(13.2)</td>
</tr>
<tr>
<td>Income tax effect</td>
<td>10.3</td>
<td>4.0</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$ (21.3)</td>
<td>$ (9.2)</td>
</tr>
</tbody>
</table>
98. On May 21, 2002, analysts Mark D. Kalinowski, Michael Albrecht and Kwame Aryeh of Salomon Smith Barney Equity Research downgraded the shares of AFC due to near term accounting issues related to whether SFAS 142 amortization applied to goodwill in the franchising of the Church's Chicken and Popeye's names. The analysts noted that AFC's earnings had not been released on time due to a change in its auditors from Arthur Andersen to KPMG. They also noted that AFC's Treasurer, Gary Hunt, had told them that there would be no restatement of past earnings. The next day, May 22, 2002, analysts Buckley and Ashley K. Reed of Bear Stearns noted that AFC's stock had fallen on news of the delayed announcement of earnings, but similarly reported that the delay had been due to AFC's new auditor reviewing the applicability of SFAS 142.

9. **The Fraud Continues: False Statements During 1Q02**

99. On May 24, 2002, AFC issued a press release reporting financial results for the quarter ended April 21, 2002. The press release reported an increase in diluted earnings per share of $0.40 for the first quarter of 2002, and a 62 percent increase in net income from continuing operations. Defendant Belatti characterized the quarter as "very solid" and emphasized management's confidence in the company's ability to meet the analyst consensus EPS estimate of $1.72 from continuing operations for fiscal year 2002.
100. On May 28, 2002, Defendants filed AFC’s first quarter 2002 Form 10-Q, repeating the financial results announced in the May 24, 2002. The 10-Q was signed by Defendant Wilkins.

101. That same day, AFC conducted a conference call to discuss the Company’s financial performance for the first quarter of 2002. During the conference call, Wilkins stated:

Operating EBITDA at 36.6 million was up 4% from a year ago. That growth rate was, again, muted by the impact of the conversions that I just mentioned, but the operating EBITDA margin increased 210 basis points and stood at 18.8%, a significant increase over a year ago. That margin was driven primarily from the higher profit margin associated with the increased royalty revenues, as well as the increased rental revenues we are now getting from the units that we converted where we kept the real estate and leased it to the franchisees.

* * *

Net income from continuing operations was up 62% to $13 million versus 8 million a year ago, and again, we saw significant improvement in the margin. Net income margin was up 290 basis points, increasing from 3.8% of revenues in the first quarter of ‘01 to 6.7% in ‘02.

* * *

Finally, looking out at 2002 on a full-year basis, we’re looking at record - record performance. Diluted earnings per share, we’re still tracking to and expect to deliver $1.72 a share. We expect to continue to see strong margin expansion. The EBITDA margin we – we’re projecting at 20.9%. The restaurant operating profit, four-wall unit level margin, we’re looking at 20.2%. And the net earnings margin should expand substantially to 8.4%.
102. Wilkins' statements alleged in ¶ 100-01 above were false and misleading for the reasons stated in ¶¶ 147-218 below.

103. In a July 22, 2002 press release, AFC announced a share repurchase program. In the press release, Belatti stated:

By almost any comparison, we believe AFC is a high performing, yet undervalued company. *AFC has consistently demonstrated its ability to deliver strong sustainable earnings growth, driven by its solid business model and strategy.* We believe we will continue to deliver a 25 percent EPS growth rate and remain comfortable with consensus earnings estimates of $0.40 per share for the second quarter 2002, and $1.72 per share for the full year.

10. **Defendants Falsely Tout Increased Earnings During 2Q02**

104. On August 13, 2002, Defendants issued a press release reporting financial results for the quarter ended July 14, 2002. The press release was titled *AFC Enterprises Reports Earnings Increase for 2002 Second Quarter, EPS From Continuing Operations of $0.40.* The press release stated:

Second quarter of 2002 vs. second quarter of 2001 highlights include:

- Diluted EPS from continuing operations increased 42.9 percent to $0.40;
- Net income from continuing operations increased 43.3 percent to $13 million;
- Net income margin from continuing operations gained 300 basis points to 8.6 percent;
- Operating EBITDA margin rose 360 basis points to 22.2 percent;
• System-wide sales increased 5.7 percent to $628 million;
• Franchise revenues were up 24.7 percent to $31 million;
• Wholesale revenues increased 7.5 percent to $16 million; and
• Total system-wide domestic comparable sales grew 0.4 percent.

105. The press release went on to say that:

AFC’s net income from continuing operations in the second quarter of 2002 increased to $13 million, or 8.6 percent of revenues, compared with $9 million or 5.6 percent of revenues for the second quarter of 2001. The improvement in net income was mostly driven by improved EBITDA margins (primarily resulting from franchising related revenues), lower amortization expense and lower interest expense.

106. Commenting on the seemingly strong financial results, Belatti stated:

We are extremely proud of our second-quarter results. AFC’s earnings remain solid as evidenced by our 42.9 percent growth rate driven by our 24.7 percent increase in franchise revenues and overall improvement in our EBITDA margin. We continue to demonstrate that we are a sound investment, consistently delivering strong results in a time of broader market uncertainty. The AFC business model is easy to understand, has straightforward measurements to evaluate execution and provides AFC a strong platform for future growth.

AFC’s focused on three primary elements to be the Franchisor of Choice: innovation, brand building and service. Our second-quarter results demonstrate that we are building of these core principles to drive out EPS growth. We are extremely excited about AFC’s future as the Company continues to grow. Even in a less than a robust economic environment, we expect to meet the analyst consensus EPS estimate of $1.72 from continuing operations for fiscal year 2002.
107. Commenting in the August 13, 2002 press release, Defendant Wilkins stated:

Our conversion strategy continues to play a key role in AFC's overall business performance. It reduces AFC's overhead costs and capital requirements, improves AFC's EBITDA and net income margins and accelerates our franchising growth strategy. It also provides franchise partners who purchased these units with immediate cash flow. This cash flow helps strengthen our franchise partners business both today, and in the future, as they add additional units. It really provides a win for both our franchise partners and for AFC and its shareholders.

108. On August 13, 2002, AFC also conducted a conference call to discuss the Company's financial performance for the second quarter of 2002. During the conference call, Belatti stated that the activities and results of the quarter were pretty much what we wanted to deliver. Strong earnings growth, with net income from continuing operations up 43 percent; strong margin improvements, up 360 basis points; strong gains in franchise and wholesale revenues, up 24 and 72 percent respectively; strong openings, 100; strong commitments, 300. Conversions of an additional 106 units continued de-leveraging strong free-cash flow of 20 million, and our continued improvements....

109. Belatti also stated that "[o]ur second quarter 10-Q will include the CEO and CFO certifications, all financial statements and SEC filings that are required by these Sarbane Oxley (ph) act. And more than just certifying the report, I'm really pleased with the systems of controls and reporting that we have in place here in the company, and I have great confidence in the transparency of our financial statements."
110. During the conference call, Wilkins added:

On the conversion front, as Frank mentioned, we converted 106 company owned restaurants to franchisees . . . and they generated about 20 million in proceeds and we signed 86 commitments for future development with those transactions. Since we’ve started the conversion program two years ago we’ve sold about 312 restaurants and generated over 80 million in cash proceeds and signed 285 commitments for future development.

* * *

Finally, from an earnings per share standpoint, diluted EPS from continuing operations was 40 cents a share . . . But the continuing operations diluted EPS of 40 cents, that did include 5 cents a share from FAS - 142 but excluding that we would have been at 35 cents versus a year ago 28 cents up 25 percent year over year.

On a full year basis, we are still looking at the dollar 72. That does include the 20 cents from FAS - 142 excluding that we would be at a dollar 52 cents which compared to the dollar 21 cents of a year ago would be up 26 percent. I would say that none of the earnings per share numbers that I’ve talked about include any gains from conversions. I know there was a little bit of confusion as it related to that.

111. At the end of the conference call, Belatti stated that “we’re going to continue to focus on the things that make the business model run well, and we fully anticipate being able to deliver on the expectations of this company from a bottom line, in earnings perspective and a margin perspective, and a return perspective.”

112. On August 14, 2002, AFC filed its second quarter Form 10-Q for the period ended July 14, 2002 which repeated the financial results published in the August 13, 2002 press release. The document was signed by Defendants Wilkins
and Belatti who certified that, pursuant to Section 906 of Sarbanes Oxley: (1) the 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and (2) the information contained in the 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

11. **Defendants’ 2Q02 Public Statements Were Materially False**

113. The financial results published in both the August 13, 2002 press release and the second quarter 2002 Form 10-Q were false and misleading for the reasons alleged more specifically in ¶¶ 147-218 below. As Defendants knew or were severely reckless in not knowing, AFC’s EPS was not the $0.40 as claimed and thus did not represent an increase of 43% as stated in the August 13, 2002 press release. As revealed by the restatement, AFC’s true second quarter 2002 EPS was only $0.28. Instead of matching the $0.40 EPS consensus, AFC actually missed it by $0.12, or 30%. As such, AFC’s second quarter actual EPS was overstated by 43%.

114. AFC’s reported net income from continuing operations of $13 million, representing an increase of 43.3%, was also false and misleading. As revealed by the restatement, AFC’s net income for the second quarter of 2002 was really only $3.4 million. *Thus, AFC’s second quarter 2002 net income was overstated by*
Contrary to the Defendants’ statement in the press release that net income increased from $9 million as reported from AFC’s second quarter 2001 financial statements, **AFC’s net income actually decreased 62% from $9 million to $3.4 million.**

115. The statements concerning the proceeds from conversions and Belatti’s assurance that no gains were included in the EPS numbers were false because, as detailed in ¶¶ 162-63, AFC improperly recognized gains on several transactions, including a 16 store deal in Mobile, Alabama, and a 55 store deal in Houston, Texas. As a result, AFC’s revenues and earnings were falsely inflated.

116. Belatti’s statement that “I have great confidence in the transparency of our financial statements” was misleading because as Belatti knew, or was severely reckless in not knowing, AFC’s financial statements grossly departed from GAAP, as alleged in ¶¶ 147-218 below, to such an extent that they were required to be restated for FY1998, FY1999, FY2000, FY2001, and the first three quarters of FY 2002. AFC had yet to issue a single set of truthful, accurate financial statements since its IPO in March 2001.

117. In reality, minus Defendants’ fraud, the Company’s restated earnings per share (EPS) for this period were $0.28, 30% less that previously stated or
predicted by the market. Without Defendants’ fraud, AFC would have missed its analysts’ EPS estimates in six out of seven quarters.

118. In marked contrast to Wilkins’ and Belatti’s certification in the 10-Q and Belatti’s statement in ¶ 109 emphasizing the Company’s “system of controls,” there were significant accounting issues existing throughout AFC. According to CW2, as early as December of 2001, the Internal Audit Department held a meeting to discuss the lack of internal controls at Seattle Coffee. During the summer of 2002, at an AFC Internal Audit Department meeting that took place at AFC headquarters, CW2 learned that AFC had issued financial statements that did not accurately depict the financial condition of Seattle Coffee, and that Seattle Coffee had a “major inventory issue.” During the Internal Audit Department meeting, CW2 learned that Seattle Coffee had done an audit of all fixed assets, and that AFC was claiming on its financial statements, “assets that were not there.” According to CW2, Wilkins was aware of the lack of internal control over the corporate and accounting aspects at Seattle Coffee.

12. **3Q02: Defendants Write-Down Seattle Coffee Inventory But Continue to Issue False Financials**

119. On November 5, 2002, Defendants issued a press release announcing that AFC’s third quarter 2002 financial results would be delayed. AFC also
provided guidance for the third quarter 2002 earnings from continuing operations of $.39 per share, excluding adjustments. The press release stated:

[T]he release of [AFC’s] results for third-quarter 2002 will be delayed pending the final determination of certain adjustments to be reported in the third-quarter 2002 or prior periods. The adjustments are limited to the Seattle Coffee Company and relate to a write down of its inventory and an impairment of its leasehold improvements at its former headquarters in Seattle. The total amount is expected to range from $1.2 million to $2.1 million after-tax.

120. Belatti stated with respect to these “adjustments:”

In the spirit of full disclosure and absolute transparency, we want to be completely certain that these adjustments are recorded appropriately.

121. There was nothing “transparent” about AFC’s financial reporting, as Belatti claimed. This is perhaps best evidenced by the significant delay incurred by KPMG in unraveling the complex accounting violations committed by AFC at the time it prepared AFC’s restatement, and the forced restatement of every one of AFC’s financial statements.

122. On November 7, 2002, a Bear Stearns analyst report noted that the Seattle Coffee adjustments reported appeared to be unimportant. Two days later, Bear Stearns spoke to Defendant Belatti, who “made it clear that he anticipates no other accounting issues and that the Company would work with new auditor KPMG to avoid embarrassing incidents like this.”
123. On November 12, 2002, AFC issued a press release announcing its third quarter 2002 financial results for the quarter ended October 6, 2002. The press release titled *AFC Enterprises Reports 34 Percent Earnings Increase for 2002 Third Quarter, EPS From Continuing Operations of $0.39 Excluding Adjustments*, stated:

- Diluted earnings per share from continuing operations increased 34.5 percent to $0.39 excluding adjustments, and increased 17.2 percent to $0.34 after adjustments;

- Net income from continuing operations increased 33.8 percent to $12.2 million excluding adjustments, and increased 17.3 percent to $10.7 million after adjustments;

- Net income margin from continuing operations gained 320 basis points to 9.0 percent excluding adjustments, and increased 210 basis points to 7.9 percent after adjustments;

- Net income increased 44.1 percent, to $12.1 million excluding adjustments, and increased 26.3 percent to $10.6 million after adjustments; and

- Adjustments of $1.5 million after-tax were recorded at AFC’s Seattle Coffee Company subsidiary and the third-quarter of 2002, including an inventory write-downs of $1.3 million and a $0.2 million impairment of leasehold improvements on its old headquarters facility.

124. On November 12, 2002, AFC conducted a conference call to discuss the Company’s financial performance for the third quarter of 2002. During the conference call, Belatti stated that he apologized for the delay in the conference call and earnings release, but that the outcome regarding the accounting adjustment
is “favorable within the range we anticipated in terms of treatment, as well as being deemed appropriate by our audit partners.” Belatti also stated that, “we’d like to begin with a restatement on our approach to conversions. First of all, I like doing them and they have been doing well.”

125. During the conference call, Wilkins stated that:

Diluted earnings per share from continuing operations increased 34.5% to $0.39, excluding adjustments. And that was versus $0.29 a year ago and increased 17.2% after adjustments.

During the quarter, we recorded adjustments of $1.5m after tax at our Seattle Coffee Company subsidiary. $1.3m of the adjustment was to write down Seattle Coffee Company’s inventory on the books to its net realizable value. The remaining $200,000 was to record an impairment on Seattle Coffee Company’s leasehold improvements on its old headquarters facility.

126. Wilkins added:

And, for the fourth quarter, we started that today. And we will be working aggressively during the remainder of the quarter to make sure that they have everything that they [auditors] need before the end of the fourth quarter so that when we get to the end of the year, we’ll have a quick, easy, clean audit. And we know that we’ll be able to release earnings when we committed to. That’s what we’re doing, and we’re confident that you won’t see any future delays.
13. **Defendants Falsely Certify AFC’s 3Q02 Results Under Sarbanes Oxley**

127. Pursuant to Section 906 of Sarbanes Oxley, Defendants Wilkins and Belatti both certified AFC’s third quarter 2002 Form 10-Q. Specifically, each certified that:

1. I have reviewed this quarterly report on Form 10-Q of AFC Enterprises, Inc.;

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

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

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

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

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the “Evaluation Date”); and
c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant’s ability to record, process, summarize and report financial data and have identified for the registrant’s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal controls; and

6. The registrant’s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

128. These financial results were repeated in the Company’s November 20, 2002 Form 10-Q signed by Defendant Wilkins.

129. The financial results published in both the November 12, 2002 press release and AFC’s third quarter 2002 Form 10-Q were false and misleading for the reasons more specifically alleged in ¶¶ 147-218 below. As revealed by AFC’s restated financial results, the Company’s third quarter 2002 EPS was only $0.31,
not the $0.39 reported. Thus, instead of meeting Wall Street’s EPS consensus of $0.39, AFC actually missed that forecast by 21%.

130. AFC’s reported net income of $10.6 million was also materially inflated, as revealed by AFC’s restatement which indicated that AFC’s net income for the third quarter of 2002 was $9.9 million. AFC’s reported net income was thus overstated by approximately 7%.

131. Belatti’s statement concerning conversions was false and misleading because of what it omitted to say. As Belatti knew or was severely reckless in not knowing, AFC had been improperly recognizing revenue prematurely from the conversion of its company-owned restaurants, as more specifically alleged in ¶¶ 152-63 below. Indeed, gains associated with conversions represented the single largest category of AFC’s twenty-one category restatement, accounting for downward revenue adjustments of $3.5 million and $8.9 million for FY2000 and FY2001, respectively, and $4.8 million for the first three quarters of 2002.

132. In addition, the problems at Seattle Coffee were far from newly discovered. In fact, for years Wilkins was aware of the existence of the Seattle Coffee problems and turned a blind eye. According to CW7, the Seattle Coffee inventory problems were in existence as far back as August 2000. In January 2001, to address the inventory problem, Wilkins traveled to Seattle “on a few
occasions to discuss the matter” but “did not want to spend the money” to replace the Enterprise System inventory management system that was in place.

133. Wilkins and Belatti’s certifications that they disclosed the existence of “...any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal controls,” was false and misleading for all of the reasons alleged herein.

14. The Truth Begins to Emerge


Despite a tough business environment, AFC had a record number of new unit openings and commitments for the fourth quarter, which in addition to comparable store sales, are key drivers to our business and earnings model. We continue to focus on the key areas, including placing a heightened emphasis on improving comparable sales performance in 2003 by insisting on operational excellence, productivity improvements and new product innovation.

135. Late on the night of January 16, 2003, AFC released significantly lower than expected fourth quarter sales data, as analysts Salomon Smith Barney, Bear Stearns and CIBC World Markets Equity Research all noted in reports issued on January 17. Bear Stearns noted that AFC also announced an unquantified non-cash impairment charge to write-down assets throughout the Company, and stated
on February 13, 2002, that “[t]he company has also suffered a loss of credibility with respect to its ability to its acquisitions capabilities, its financial reporting and controls, and its ability to deliver on projected earnings.”

B. AFC’S MASSIVE FINANCIAL RESTATMENT IS ANNOUNCED

136. On March 24, 2003, Defendants shocked the market when the Company announced that it would not timely file its Form 10-K for FY 2002 and that when it was eventually filed, it would restate AFC’s reported financial results for 2001 and the first three quarters of 2002.

137. In response to this disclosure, AFC’s stock plummeted 21% from $17.10 on March 24, 2003 to a closing price of $13.40 on March 25, 2003, on heavy trading volume.

138. Salomon Smith Barney analyst Mark Kalinowski called the restatement announcement a “bombshell” in a report to investors, and withdrew his 2003 earnings and target price until the restatements were clarified.

139. Morgan Stanley Investment Manager Richard Glass voiced Wall Street’s shock over the news during a March 24, 2003 conference call stating: “[t]here has to be some accountability in the company and changes need to be made if management is at all ... interested in regaining any credibility in the financial community. Because right now it’s got to be zero – or below zero.”
140. Even AFC’s own investment bankers – namely, Defendant Credit Suisse First Boston Corporation -- acknowledged the damage to AFC’s credibility as a result of this unexpected disclosure. On April 3, 2003, securities analysts John S. Glass and Jeffrey D. Farmer of Defendant Credit Suisse First Boston Corporation stated in a report on the Company that it would “…take a considerable amount of time before the company rebuilds shareholder credibility.”

141. On August 14, 2003, AFC issued a press release, announcing that the Company’s Audit Committee had delivered to the Nasdaq Listing Qualifications Panel a report on the investigation it had conducted regarding AFC’s need to restate its financial statements. The Audit Committee concluded that AFC lacked adequate internal controls and accounting procedures and that the accounting and financial reporting functions investigated needed improvement. The Audit Committee further concluded that AFC’s internal technical accounting expertise was not as strong as it needed to be, and that enhanced training and staffing in the accounting and audit areas were also needed.

C. THE MAGNITUDE OF THE RESTATEMENTS IS REVEALED

142. On December 15, 2003, Defendants filed AFC’s Form 10-K for the year ended December 29, 2002. In it, Defendants disclosed the effect and magnitude of the restatements as follows:
The aggregate effect of the restatement decreased previously reported net income for fiscal years 2001 and 2000 by $21.3 million and $9.2 million, respectively. The aggregate effect of the restatement decreased previously reported basic and diluted earnings per share by $0.73 and $0.69, respectively, for 2001 and by $0.34 and $0.32, respectively, for 2000. The restatement also affected years prior to 2000, reducing shareholders' equity at December 26, 1999 by $5.4 million. The matters giving rise to the restatement and the effect of the corrections of those accounting errors on previously reported earnings for fiscal years 2001 and 2000 were as follows:

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<tr>
<td>Accrued liabilities</td>
<td>(0.7)</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>(0.9)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Business taxes and related professional fees</td>
<td>(0.9)</td>
<td>0.2</td>
</tr>
<tr>
<td>Slotting fees at Seattle Coffee</td>
<td>(0.9)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Beverage rebates</td>
<td>(0.8)</td>
<td>0.3</td>
</tr>
<tr>
<td>Rent expense</td>
<td>(0.8)</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Sales allowances at Seattle Coffee</td>
<td>(0.6)</td>
<td>(0.2)</td>
</tr>
<tr>
<td>Recognition of re-imaging costs</td>
<td>(0.6)</td>
<td>0.3</td>
</tr>
<tr>
<td>Future lease obligations – closed units</td>
<td>0.8</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Advertising funds</td>
<td>(0.4)</td>
<td>(0.3)</td>
</tr>
<tr>
<td>Leasehold improvement – useful lives</td>
<td>(0.3)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Legal accrual</td>
<td>-</td>
<td>1.5</td>
</tr>
<tr>
<td>Capitalized expense</td>
<td>-</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Workers’ compensation accrual</td>
<td>-</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Group medical insurance accrual</td>
<td>-</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Other</td>
<td>0.3</td>
<td>0.1</td>
</tr>
<tr>
<td>Income tax effect</td>
<td>10.3</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>(31.6)</strong></td>
<td><strong>(13.2)</strong></td>
</tr>
<tr>
<td>Income tax effect</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

64
143. The magnitude of the restatement is perhaps best illustrated by the size of the downward adjustment made to AFC’s net income for FY 2000 and FY 2001, as highlighted by the chart below:

<table>
<thead>
<tr>
<th></th>
<th>Originaly Reported</th>
<th>Restated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$(21.3)</td>
<td>$(9.2)</td>
</tr>
</tbody>
</table>

144. The Company’s restated net income in FY 2000 from $27.5 million to $18.3 million demonstrates that AFC’s actual FY 2000 net income was overstated by 50%. Similarly, the Company’s restated net income in FY 2001 from $36.9 million to $15.6 million showed that AFC’s actual reported net income for FY 2001 was overstated by 136%. Shortly thereafter, an article titled Fried, appearing
in the December 22, 2003 edition of the Delaney Report, noted that Belatti’s credibility was called into question even internally by employees of the Company:

Observers are wondering about the future of Frank Belatti, chairman/ceo at Atlanta, Ga.-based fast food operator AFC Enterprises (includes Church's Chicken, Popeye's Chicken & Biscuits, Cinnabon). Belatti gets a black eye over AFC's accounting restatements. Belatti survives the financial scandal, but sources say that Frank now has lost credibility among the AFC troops.

D. AFC'S FALSE AND MISLEADING FINANCIAL STATEMENTS

145. In order to inflate the price of AFC securities, Defendants caused the Company to falsely report its financial results for fiscal years 1998, 1999, 2000 and 2001 filed with its Registration Statements, Prospectuses and Forms 10-K, and for the first three quarters of 2002 on Forms 10-Q, as well as financial results included in press releases and other SEC filings throughout the Class Period, in violation of GAAP and SEC rules. Defendants did so by deliberately, or at least severely recklessly, employing a host of accounting schemes and manipulations, including the following: (a) improperly failing to defer gains associated with restaurant sales to franchisees; (b) improperly understating current expenses by various means (including improper deferral of expenses, improper capitalization of expenses and overstatement of depreciable asset lives, among others); (c) failing to write down known impaired assets; (d) improperly overstating inventory; (e) improperly understating accrued liabilities; (f) improperly capitalizing interest on completed
construction projects; (g) improperly accounting for rebates; (h) improperly reducing certain lease expense by first subtracting fictitious sublease rental income; (i) failing to consolidate and include Popeye’s and Church’s advertising funds and expenses in AFC’s financial statements; and (j) failing to record accruals accurately. AFC has admitted the falsity and restated the previously reported numbers.

146. AFC’s accounting improprieties detailed herein violated GAAP and SEC rules. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP. 17 C.F.R. §210.10-01(a).

1. **AFC’s Enormous Financial Restatement**

147. As a result of employing the numerous fraudulent accounting practices prior to and throughout the Class Period alleged herein, outside auditor KPMG required AFC to comply with GAAP and restate its financial statements for
1998, 1999, 2000, 2001, and the first three quarters of 2002 – that is, every single financial statement it issued from the time of its IPO.

<table>
<thead>
<tr>
<th></th>
<th>FY 2000</th>
<th>FY 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reported</td>
<td>Restated</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$725.2</td>
<td>$723.2</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>643.6</td>
<td>655.9</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>81.6</td>
<td>67.3</td>
</tr>
<tr>
<td>Net Income</td>
<td>27.5</td>
<td>18.3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>IQ 2002</th>
<th>2Q 2002</th>
<th>3Q 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reported</td>
<td>Restated</td>
<td>% Actual Overstated</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$194.4</td>
<td>$194.8</td>
<td>-0.2%</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>168.0</td>
<td>165.8</td>
<td>1.3%</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>26.4</td>
<td>29.0</td>
<td>-9.0%</td>
</tr>
<tr>
<td>Net Income</td>
<td>-4.4</td>
<td>3.1</td>
<td>-241.9%</td>
</tr>
</tbody>
</table>

The fact that AFC restated its financial statements is an admission that: (i) the financial results originally issued during the Class Period and its public statements regarding those results were materially false and misleading; and (ii) the financial statements reported during the Class Period were incorrect based on information available to Defendants at the time the results were originally reported.

48. As recently noted by the SEC, "GAAP only allows a restatement of prior financial statements based upon information `that existed at the time the financial statements were prepared,'" and "restatements should not be used to make any adjustments to take into account subsequent information that did not and
could not have existed at the time the original financial statements were prepared.\textsuperscript{10} The Accounting Principles Board ("APB") has defined the kind of "errors" that may be corrected through a restatement: "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that \textit{existed at the time that the financial statements were prepared}."\textsuperscript{17} See APB 20 ¶7-13. The restatement at issue here was not due to a simple mathematical error, honest misapplication of a standard or oversight, or instead, as alleged below, it was due to intentional misuse of the facts known at the time the financial statements were prepared and issued to the investing public.

149. The SEC has recently reiterated its position that, in its investigations of restated financial statements, it often finds that the persons responsible for the improper accounting acted with scienter:

\begin{quote}
[T]he Commission often seeks to enter into evidence restated financial statement, and the documentation behind those restatements, in its securities fraud enforcement actions in order, inter alia, to \textbf{prove the falsity and materiality of the original financial statements [and] to demonstrate that persons responsible for the original misstatements acted with scienter}. In re Sunbeam Sec. Litig., No. 98-8258-Civ.-Middlebrooks (S.D. Fla. filed Jan. 31, 2002) (SEC Amicus Curiae Brief regarding Defendants Motion In Limine to Exclude Evidence of the Restatement and the Restatement Report ).
\end{quote}

Amicus Curiae Brief Regarding Defendants’ Motion *In Limine* to Exclude Evidence of the restatement and Restatement Report).

150. The restatements at issue in this case contain at least nine indicators of scienter:

i. *The type of restatement (misuse of the facts)* - The restatement at issue was due to misuse of the facts. As alleged below, in many instances, AFC either knew what the correct accounting treatment was, and ignored it, or recklessly turned a blind eye to the information they had.

ii. *The size of the restatement* – AFC’s actual operating income was overstated by 21% and 59%, and actual net income was overstated by 50% and 136% in 2000 and 2001 alone, respectively.

iii. *The sheer number of improper accounting manipulations employed* – at least 22.

iv. *The duration over which the improper accounting was perpetrated* – As more fully detailed herein, AFC restated five years of financial statements to correct fraudulent accounting from 1998 through 2002. *It restated every single year end financial statement it issued to potential IPO investors prior to going public, and after, through the third quarter of 2002.*

v. *The types of accounting manipulations employed* - As detailed herein, the improper accounting corrected by this restatement did not occur as a
result of good faith differences in accounting judgments, or interpretations of complicated or vague accounting rules. The accounting rules and precepts violated by AFC were long established, basic accounting standards and concepts, such as the most basic rule of recording an expense in the period it was actually incurred. The accounting manipulations used by AFC are as old and basic as they come—namely, the improper pushing of expenses to later periods, or improper capitalization of ordinary expenses to avoid the current period hit.

vi. The fact that the improper accounting was widespread, pervasive, systematic and not limited to a single division or subsidiary.

vii. The virtual unanimity with which the “errors” inflated, not reduced, net income and earnings.

viii. The improper accounting was not a result of inexperienced accounting managers who did not understand accounting rules, nor can it be blamed solely on poor accounting controls— to the contrary, AFC’s financial officers knew what they were doing. They were experienced CPA’s and seasoned financial professionals with significant accounting, auditing and SEC reporting experience. For example, Defendant Wilkins, the Chief Financial Officer, trained and was employed as a CPA with a “Big Six” (the six largest, most prestigious, international accounting firms in the world) accounting firm, and received an MBA
from Stanford. Similarly, before coming to AFC, the Director of SEC Financial Reporting, who reported to Wilkins, was a seasoned CPA and audit manager with Arthur Andersen, where he specialized in auditing financial statements of the Quick Service Restaurant industry – the industry that AFC belong to. Both of these officers, as a result of their “Big Six” accounting and auditing background were well versed in evaluating, establishing, and auditing accounting policies, practices and internal accounting controls.

ix. Tellingly, Defendants in this case did not themselves discover their “error” and report it while re-reviewing earlier facts and rush to come forward; instead, they were caught by KPMG, their new outside auditors, and forced to restate.

151. AFC published the following table in its 8-K filed December 15, 2003, detailing the adjustments required to restate its previously issued financial statements for fiscal years 2000 and 2001 and the first three quarters of 2002:

**RESTATEMENT OF FINANCIAL STATEMENTS**

The following is a summary of the adjustments to AFC’s previously issued financial statements for fiscal years 2000 and 2001, and the first three quarters of fiscal year 2002.

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>EFFECT ON PREVIOUSLY REPORTED EARNINGS INCREASE (DECREASE)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1-Q3</td>
</tr>
<tr>
<td>1) Gains associated with unit conversions</td>
<td></td>
</tr>
</tbody>
</table>
These restated line-items were improper when originally recorded for the following reasons among others:

2. **AFC Failed to Defer Gains Associated with Unit Conversions**

152. During the Class Period, AFC sold certain company-owned restaurants, bakery or café units to franchisees. AFC refers to this type of transaction as a “conversion.” This conversion program was highly touted by Defendants during the Class Period as a way for AFC to boost the bottom line. AFC improperly and prematurely recognized gains on many of these sales to
franchisees immediately at the time it sold the company-owned restaurant, bakery or café units to franchisees. Because AFC continued to have significant ongoing obligations and involvement in the assets or financing of the purchase of the assets beyond the customary franchisor role, GAAP precluded immediate gain recognition and instead, required material portions of the gain to be recognized ratably over the period of continued involvement. For example, according to CW1, AFC often provided franchisees with a “development note” that provided the franchisee with the money necessary to purchase the stores. As long as the franchisee met certain AFC-established development goals for five years, the franchisee’s debt obligation was extinguished.

153. AFC’s typical conversion transaction involved the sale of restaurants, bakeries or cafes in a multi-unit group, and that each group “often” involved a mixed deal structure with regard to the sale of the assets to the franchisee. A mixed deal structure is one in which not all parts of the transaction are treated in the same manner. For example, AFC often would sell some restaurant assets, and lease others, to the franchisee. In such situations, GAAP clearly required that the portion of the gains related to the leased assets be deferred because AFC continued to maintain continuing involvement with the assets beyond the customary franchisor role.
154. In addition, AFC's own disclosures in their financial statements demonstrate that the Company often had ongoing contingent liabilities relating to financing the sale of the assets to the franchisee. For example, AFC typically provided loan and/or lease guarantees on behalf of the franchisee buying an AFC store. Such arrangements clearly illustrate that AFC had significant, continuing obligations, contingent or otherwise. Accordingly, in each conversion transaction, the proceeds should have been allocated among the different deal components, and where the Company had significant ongoing involvement, such as serving as a landlord for some of the unit properties or providing seller financing or loan guarantees, a portion of the gain should have been deferred and recognized over the term of the continuing involvement in accordance with GAAP. However, during the Class Period, AFC was simply recognizing revenue for all the components of a deal at the time of the conversion without taking its outstanding obligations into consideration.

155. Statement of Financial Accounting Standards ("FAS") No. 45, Accounting for Franchise Fee Revenue, ¶3, among others, clearly states that revenue from franchise sales and fees cannot be recognized until a franchise sale transaction is completed – that is when all material services or conditions relating to the sale have been substantially performed or satisfied by the franchisor.
Despite having known significant ongoing involvement or contingent liabilities associated with the sale or lease of certain assets, AFC disregarded FAS 45 and simply recorded all revenue immediately.

156. Under FAS No. 13, *Accounting for Leases*, and FAS No. 98, *Accounting for Leases*, both operating leases and direct financing leases require that the lease payments be reported to income periodically over the lease term. See FAS 13 ¶¶18, 19, FAS 98 ¶22. Despite the fact that several of the conversions involved leases, AFC improperly recognized all gains immediately.

157. Additionally, SEC Staff Accounting Bulletin ("SAB") No. 103, *Topic 13: Revenue Recognition*, states that revenue generally is realized or realizable and earned when all of the following criteria are met: (a) persuasive evidence of an arrangement exists; (b) delivery has occurred or *services have been rendered*;\(^\text{11}\) (c) the seller’s price to the buyer is fixed or determinable; and (d) collectability is reasonably assured. As AFC still had significant outstanding obligations for the mixed deal structure agreements at the time of the conversions, not all the services,

\(^{11}\) "Revenue should not be recognized until the seller has substantially accomplished what it must do pursuant to the terms of the arrangement, which usually occurs upon delivery or performance of the services." See FASB Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* at ¶84; SAB 103.
obligations or liabilities had been rendered and, therefore, revenue should not have been recognized at that time.

158. AFC belatedly admitted in recent SEC filings that this premature gain recognition was improper, and therefore the Company was forced to correct this improper accounting in its 2000, 2001 and 2002 restatement. By prematurely and improperly recognizing gains associated with the sales of certain company-owned stores to franchisees, AFC inflated its revenue by $3.5 million, $8.9 million, and $4.8 million in 2000, 2001, and the first three quarters of 2002, respectively.

(a) Wilkins Implements and Enforces AFC’s Conversion Plan

159. The improper revenue recognition on gains relating to these conversions was known or recklessly disregarded by Defendants, especially Wilkins. According to CW1, in 2000, AFC instituted a “policy change” with regard to the conversion of company-owned stores to franchisees. Wilkins engineered the conversion plan to “make the company’s earnings look better” and provide an “immediate impact on positive earnings and EBITDA.” Wilkins wanted to spread the policy of converting company-owned units to franchisees throughout AFC. Wilkins engineered the program to have “rents coming in” so the Company could have a continuous revenue stream, and did not want to sell the underlying real estate with the franchise. During a December 2001 “family
gathering,” Wilkins outlined AFC’s new strategy and committed to having the store conversions add $30 million to AFC’s earnings. During the Class Period there were weekly meetings held in the Peachtree Conference Room at AFC headquarters to make sure the conversions were going through, and weekly conference calls to discuss the conversion process and pending transactions.

(b) Wilkins Authorized Conversion Deals That Included Improper Gains

160. According to CW1, Kathy King (AFC Vice President of Finance) and Defendant Wilkins were intimately involved in the conversion process. Indeed, Wilkins was required to sign off on “all of the [conversion] deals.” Prior to each conversion being finalized, a document was prepared entitled “Sale of Church’s Company Restaurant – Approval.” This document included several sections, including: (1) a description of the deal terms; (2) an analysis of the “Impact on Brand EBITDA” that summarized the lease termination fees, if any, and the net EBITDA impact of the sale; (3) the rental income to AFC, if applicable, interest savings and the impact on pre-tax earnings; and (4) any “New Development Commitments.” The document required signatures from a Vice President of Development, the National Director of Real Estate, Church’s COO, and

12 “Family gatherings” were management level meetings held at AFC’s headquarters.
specifically required Wilkins' approval and signature prior to any deal closing. On
the final page of each Approval Document, the net gain on each sale was clearly
listed. A separate approval document was generated for each set of conversions.

161. It was apparent from the face of these documents provided to, signed,
and “okayed” by Wilkins during the Class Period, that full net gains on these
closings were recognized even when AFC continued to owe obligations to the
franchisee.

162. For example, according to an Approval Document generated with the
closing of Church’s stores in Alabama (referenced in the Document as stores
numbered 288, 343, 344, 411, 536, 1101, 1109, 1193, 1563, 389, 1137), it was
apparent that AFC would continue to lease land to the purchasers of each store, and
AFC – with Wilkins’ approval – nonetheless recognized a $1,966,076 net gain on
the sale of these franchises at the time, in direct violation of GAAP.

163. In addition to the Alabama deals, CW1 was aware of two deals
involving the conversion of Popeye’s Chicken franchises in Dallas and Houston
during the Class Period. In these two transactions, AFC “kept the property” and
leased it to franchisees, but nonetheless immediately booked a $5 million gain on
the Houston conversion and a $3.5 million gain on the Dallas transaction. In
addition, the following deals involved fraudulent recognition of gains despite AFC's continuing obligations:

(a) **Tampa** – The 14 Tampa franchises of Church's Chicken were sold for approximately $3.6 million. AFC recognized the full amount of roughly $900,000 in gains on the transaction even though AFC continued to own and lease 11 of the properties involved in the transaction;

(b) **Houston/Beaumont** – AFC sold 55 Church's Chicken stores in the Houston/Beaumont area to David Davoudpour, who ran an entity named Royal Capital Corp. The transaction closed in September or October 2002, and was publicly announced in a June 19, 2002 AFC press release entitled “Church’s Chicken Franchisee Purchases 57 Restaurants.” The purchase price for all 55 stores was $12.5 million. Although AFC “leased or subleased” all 55 of the stores to the franchisee, the Company recognized a full gain of approximately $3.6 million on the transaction;

(c) **Mobile, AL** – AFC sold 16 stores to Kevin Whitfield in a transaction that closed in July 2002. AFC continued to own the real estate for all 16 stores, and leased the property to Whitfield. This deal was announced in an October 2, 2001 press release;

(d) **Oklahoma** – AFC sold 10-11 stores in Oklahoma in a transaction that closed in November 2002; and

(e) **Louisiana** – The Louisiana market transaction, a deal to convert 35 company-operated restaurants throughout Louisiana, was announced by AFC closed shortly before the fourth quarter of 2002. AFC was “scrambling” to ensure the transaction would close “because they needed to make the quarter.”

164. In addition to the specific Deal Approval documents, CW1 maintained a flow-chart setting forth all of the “on-going” deals CW1 was working on, and the expected impact of the deal on the Church’s Chicken EBITDA. These charts were
submitted to King on a quarterly basis, and King, in turn, combined similar reports for each division in a “Brand Review Book.” The Brand Review Book, which was approximately 30 pages in length, was a bound book displaying Profit and Loss statements, comparable sales and conversion reporting for each brand. The Brand Review Book was distributed quarterly to AFC senior executives, including Wilkins, Holbrook and Belatti.

3. **AFC Improperly Understated Expenses**

165. In blatant violation of some of the most basic, fundamental rules of accounting, AFC repeatedly devised ways to artificially inflate net income and earnings by improperly, systematically and continually understating expenses prior to and throughout the Class Period. GAAP requires expenses to be recorded in the period in which they are incurred. See CON 5 ¶¶85-87. This concept, that expenses be recorded in the same period in which the corresponding benefit is realized, is one of, if not the, most basic tenets underlying all accrual accounting. AFC, including its financial officers, however, deliberately or severely recklessly ignored this most basic rule, and systematically engaged in a scheme of improper timing of expense recognition. Typically, AFC understated its expenses in a current period and/or improperly delayed expense recognition for as long as
possible – in this case, until they were caught by KPMG, the Company’s new auditors.

166. AFC improperly timed expense recognition in at least the following ways: (a) by improperly deferring current period expenses to later periods; (b) by improperly capitalizing non capitalizable expenses as assets and amortizing them over time rather than correctly expensing them at the time they were incurred; (c) by failing to record rent expense on a straight-line basis for its leases; (d) by improperly assigning inappropriately long useful lives to leasehold improvements, which resulted in artificially reduced depreciation expense for any given period; (e) by misclassifying professional tax fees to liability accounts instead of expensing them as incurred; and (f) by accruing and capitalizing certain acquisition costs instead of expensing them as incurred.

(a) Improper Deferral of Expense to Later Periods

(i) AFC Deferred Expensing Post-Employment Payments to a Former Officer

167. AFC improperly inflated earnings by deferring recognition of post employment payments to an officer who had left the Company. Prior to February 7, 2001, Samuel N. Frankel served as AFC’s General Counsel and Secretary of the Company and as a member of its Board of Directors. The fourth amendment to his employment agreement with AFC dated February 9, 2001 stated that, upon his
termination as an employee of the Company, he would become engaged as an independent contractor to purportedly provide consultation and advice to the CEO, and his compensation was set at $350,000 per year for a period of ten years. However, the agreement expressly stated that, to earn this fee, there was no minimum amount of time that Frankel was to be required to perform consulting services and his unavailability to provide such services would not be considered a breach. Essentially, the future payments were a reward for his past service to AFC and the agreement stated this.

168. GAAP requires “[a]n expense or loss [to be] recognized if it becomes evident that previously recognized future economic benefits of an asset have been reduced or eliminated, or that a liability has been incurred or increased, without associated economic benefits.” See CON 5 ¶87. GAAP also clearly states that the total liability for such post-employment benefits is to be accrued in the current period by a charge to income. See FAS 112 ¶6. Despite the fact that Frankel was no longer providing a material future economic benefit to the Company as no additional services were required to be performed, AFC improperly deferred the expenses related to these post-employment payments and was recognizing the expenses over the term of the ten year agreement, rather than expensing the entire obligation in 2001, as required by GAAP, when the agreement became effective.
169. AFC has since restated its financial statements to reflect the correction of this accounting. By failing to expense the entire obligation when incurred, AFC understated its expenses by $2.9 million in 2001.

(ii) **AFC Failed to Properly Accrue Sales Discounts and Allowances Given to Customers**

170. Like most businesses, AFC’s Seattle Coffee subsidiary offered discounts and allowances to its wholesale customers. However, unlike most businesses, AFC improperly delayed recording these sales discounts and allowances as expenses until they actually paid such discounts or credited the customers’ accounts. GAAP and basic accrual accounting require that such discounts and allowances be estimated and accrued in the period that the associated revenue is recognized. Accrual accounting in accordance with GAAP requires the matching of related revenues and expenses to reflect an entity’s performance during a period instead of merely listing its cash receipts and outlays. *See CON 6 ¶¶145-146 and CON 5 ¶86.*

171. As a result of its failure to properly record sales discounts and allowances, AFC understated its expenses by $0.2 million and $0.6 million in 2000 and 2001, respectively. It has since restated these expenses for the above periods.
(b) Capitalization of Expenses

(i) AFC Improperly Capitalized Certain Marketing Expenses

172. AFC improperly capitalized certain customer related costs that should have been expensed as incurred. By improperly capitalizing these costs, AFC recorded assets that would slowly be depreciated over the estimated life of the asset, rather than expensed immediately as incurred (which results in an improper reduction of earnings). For example, AFC’s Seattle Coffee subsidiary improperly capitalized costs for certain equipment and marketing items it gave to customers for marketing purposes and sales of the Seattle Coffee products. AFC improperly capitalized these costs despite the fact that it no longer owned or controlled these items or the items were of a marketing nature. GAAP accounting requirements are crystal clear in this area – such costs should have been recognized as marketing expenses and been expensed in the periods in which the equipment was placed in service in accordance with American Institute of Certified Public Accountant (“AICPA”) Statement of Position (“SOP”) 93-7, Reporting on Advertising Costs, which requires advertising costs to generally be expensed either as they are incurred or the first time advertising takes place.

173. AFC has since restated its improper accounting for these expenses. By improperly capitalizing these costs, AFC understated its expenses by $1.6
million, $1.4 million, and $0.1 million in 2000, 2001, and the first three quarters of 2002, respectively.

(ii) **AFC Improperly Capitalized “Slotting Fees”**

174. AFC, through its Seattle Coffee subsidiary, also capitalized “slotting fees” paid or credited to wholesale customers for favorable shelf space and improperly amortized these fees over a two year period. AFC amortized these fees over a two year period despite the fact that neither the slotting agreement nor the written contract contemplated that the fees covered an extended two year period. These slotting fees were regular marketing costs that did not cover future periods and, accordingly, should have been expensed immediately as sales discounts when incurred in accordance with SOP 93-7 and the matching principle of accounting.

175. It is clear that AFC was also purposefully manipulating its slotting fee expenses in other ways. In addition to the above, CW6 was instructed by a superior to purposely delay posting credits taken by customers for slotting fees and advertising owed them to the general ledger “in order to make the quarter look better.” This made the quarter “look better” because an expense or “credit” was not recorded.

176. By improperly capitalizing these costs, AFC understated its expenses by $0.1 million, $0.9 million, and $0.3 million in 2000, 2001, and the first three
quarters of 2002, respectively. AFC has since restated this improper accounting.

(iii) **AFC Improperly Capitalized Overhead**

177. AFC improperly capitalized certain construction overhead costs and other amounts that should have been expensed as incurred. Capitalizing such general and administrative expenses is only permissible under GAAP to the extent these costs were directly related to the acquisition of assets with a future economic benefit to the Company. See SEC Accounting and Audit Enforcement Release ("AAER") No. 1481. GAAP requires that unnecessary expenditures that do not add to the utility of the asset should be charged to expense.

178. AFC has since restated this improper accounting. By improperly capitalizing these overhead costs, AFC understated its expenses by $1.3 million and $0.2 million in 2000 and the first three quarters of 2002, respectively.

4. **Improper Understatement of Rent Expense**

179. In violation of GAAP, AFC did not record rent expense on a straight-line basis for all leases. AFC entered into lease agreements that contemplated escalating rent payments over a period of years. Such lease clauses are commonplace in business, and a landlord will often offer lower than market rates

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13 Under the “straight-line” method, the total payments over the life of the lease are used to calculate an average payment. The resulting average payment is then recorded as an expense in each period instead of the actual monthly payment.
on the front-end of a lease to make the lease more attractive to prospective lessees. A landlord then typically recoups this loss from the low front-end rent payments on the back-end of the lease when payments typically escalate. However, for financial reporting purposes, GAAP recognizes that such below market initial payment and escalating payment terms cause a distortion of the true cost of the lease at any given period in the financial statements. Accordingly, basic GAAP makes it clear that the average payment ("straight-line basis") must be recorded. "[I]f rental payments are not made on a straight-line basis, rental expense nevertheless shall be recognized on a straight-line basis unless another systematic and rational basis is more representative..." See FAS 13, Accounting for Leases. ¶15. FAS 13 also requires that the lease term used to calculate the straight line payment also include the effect of renewal options that are reasonably expected to be exercised.

180. By improperly recording the actual rent payments early in the lease instead of calculating and recording the average rent, AFC improperly recorded less rent expense than required by GAAP. Notwithstanding the fact that "straight-lining" rent under FAS 13 is a common, well-known accounting rule, it is clear that AFC knew or severely recklessly disregarded the rule. For example, the restatement disclosures in AFC’s 2002 10-K revealed that it applied the "straight
line” rule to some leases, but ignored it on others. Additionally, it is quite telling that, on the one hand, AFC ignored this accounting rule when its application would reduce AFC’s net income but on the other hand, if it benefited AFC’s net income to adopt this correct accounting rule, they did so. For example, as disclosed in the 2002 10-K financial statement footnotes, when AFC was involved in a lease transaction as a landlord receiving rents, it complied with FAS 13 accounting rules and recorded rental income on an average, “straight-line” basis. It did this because, not coincidentally, complying with FAS 13 was profitable and allowed AFC to record more rental income in the earlier years of a lease than it was actually receiving in rental payments.

181. While the brunt of this impropriety resulted in understated expenses of $3.8 million in years prior to 2000, it also resulted in understated expenses during the Class Period of $1.0 million, $0.8 million, and $0.6 million in 2000, 2001, and the first three quarters of 2002, respectively. AFC has since restated this improper accounting.

5. **Inflation of Asset Useful Life Estimates to Understate Expenses**

182. AFC manipulated expenses by using inflated useful life estimates for leasehold improvement depreciation purposes, where the useful life chosen for the leasehold improvements actually exceeded the lease term. The useful life of an
asset for accounting purposes is the estimated length of time that it will benefit the Company; in the case of a leasehold improvement, useful life would not exceed the term of the lease. AFC improperly recorded inflated useful lives beyond the lease term because it allowed AFC to record smaller, understated depreciation expenses in each period. GAAP clearly requires that such “an asset shall be amortized in a manner consistent with the lessee’s normal depreciation policy except that the period of amortization shall be the lease term.” See FAS 13, Accounting for Leases, ¶11, emphasis added.

183. AFC eventually was forced to restate its accounting for its leasehold improvements to comply with GAAP. As a result of these accounting improprieties, AFC understated expenses by $0.1 million, $0.3 million, and $0.6 million in 2000, 2001, and the first three quarters of 2002, respectively.

6. **Failure to Expense Professional Tax Fees as Incurred**

184. AFC hid tax fees paid to professionals, and miscellaneous business taxes, in the Company’s income tax liability accounts and failed to properly recognize expenses. Such fees should have been classified in normal general liability accounts, and the business taxes and related professional fees should have been expensed as incurred. GAAP requires expenses to be recorded in the period they are incurred. See CON 5 ¶¶85-87. By burying business taxes and fees in the
income tax liability accounts normally associated with the income tax payable and deferred income tax accounts, the failure to record the expenses was harder to detect. AFC was eventually forced to restate its improper accounting for these business taxes and professional fees. As a result of these improprieties, AFC understated its expenses by $0.9 million and $0.2 million in 2001 and the first three quarters of 2002, respectively.

7. **Improper Recognition of Expenses for Renovations and Improvements**

   185. AFC frequently performed renovations, upgrades and other improvements aimed at re-imaging its stores. In violation of GAAP, AFC admitted in its restatement disclosures that it improperly recorded the expense such re-imaging costs based on the mere *planned* dates of the re-imaging activities rather than the actual dates in which they were incurred. Nothing in GAAP allows the early recognition of normal, recurring asset purchases on a mere “planning” basis. GAAP, including CON 5 ¶¶85-87, requires expenses to be recorded in the period they are incurred. AFC was eventually forced to restate its improper capitalization for planned renovation projects. As a result of its improper accounting, AFC’s expenses in 2001 were overstated by $0.6 million.
8. **Improper Purchase Accounting**

186. In 1998, AFC acquired Cinnabon. AFC improperly accrued or capitalized certain general overhead expenses as acquisition costs in connection with this acquisition when such expenses should have been expensed as incurred. By capitalizing indirect, general overhead costs instead of expensing them in the current period when incurred, AFC improperly amortized these costs over several years in order to report artificially lower expenses in the current year. GAAP requires that “indirect and general expenses related to acquisitions [must be] deducted as incurred in determining net income.” See APB 16, *Business Combinations*, ¶76.

187. Also in connection with the Cinnabon acquisition, in order to improperly avoid recognizing the true expense impact of the Cinnabon acquisition each year going forward, AFC artificially undervalued the acquired assets of Cinnabon and overvalued the acquired goodwill. Generally, in purchase accounting the excess of the purchase price of Cinnabon that exceeded the identifiable fair value of its assets should have been recorded as “goodwill.” Going forward, both the identified assets and goodwill of Cinnabon would be depreciated to expense each year over their respective useful lives. Cinnabon’s identifiable assets generally had a useful life of less than ten years, while AFC
assigned goodwill a suspiciously long 40 year life. However, in this case to improperly avoid recording the true amortization costs, AFC improperly understated the fair values of acquired bakeries and identifiable intangible assets, thereby overstating the remaining purchase price allocated to goodwill. The benefit of improperly undervaluing the identifiable assets was this: Because AFC’s forty-year amortization period for goodwill was significantly longer than the periods used to depreciate/amortize the other assets, the more of the purchase price AFC improperly allocated to goodwill (with 40 year amortization), the more it could dramatically understate Cinnabon’s depreciation and amortization expenses going forward throughout the Class Period.

188. AFC has since restated its improper accounting for the Cinnabon acquisition. As a result of its failure to properly account for the Cinnabon purchase accounting or correct it during the Class Period, AFC overstated expenses by $1.5 million, $2.4 million and $0.9 million in 2000, 2001 and the first three quarters of 2002, respectively.

9. **AFC Failed to Write Down Impaired Assets at Poorly Performing Stores**

189. AFC violated GAAP by improperly failing to write down the value of certain company-owned stores that were performing poorly, or would be closed, in a timely manner. Despite stating in its 2000 and 2001 Forms 10-K that (1)
management periodically reviewed the performance of restaurant, bakery, café and other long-lived assets, and (2) when it was determined that a store would be closed, the carrying value of the property and equipment was to be adjusted to net realizable value, AFC failed to write down the value of such impaired assets.

190. FAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, ¶4-5 requires an entity to review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts on the books may not be recoverable. FAS 121 further states that an example of such an event is “[a] current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.” The rule further states that, when an asset is determined to be impaired, it should be written down to its net realizable value and a loss shall be recognized at that time.

191. AFC knew or severely recklessly disregarded exactly which stores were impaired and which were not, yet it failed to write down the impaired assets. For example, AFC systematically tracked the financial performance of each company-owned store, as evidenced by detailed internal profit and loss reports that tracked, on a store-by-store basis, sales, expenses and store operating profit or loss.
These reports break out the expenses in minute detail by type, by line item, in columns for each month, on a separate page for each store, and by store number. Despite this knowledge or severely reckless disregard of which stores were not profitable and therefore were, in accounting parlance “impaired,” AFC refused to properly write down impaired properties because it would negatively impact the Company’s net income.

192. The Company’s claim in its December 15, 2003 Form 8-K that this failure was simply an “oversight” attributable to the fact that it evaluated its properties on a “market basis” rather than a site-by-site basis is nonsensical, simply false and refuted at a minimum by the available information in the above reports. This explanation is further discredited by, among other things, the fact that AFC clearly monitored this information to determine which stores to close (a monitoring practice it disclosed in the footnotes to its Forms 10-K for 2000 and 2001).

Clearly, AFC possessed the individual store information, yet failed to write down the impaired assets as required by GAAP:

The Board concluded that for testing whether an asset is impaired and for measuring the amount of the impairment loss, assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. See FAS 121 ¶95.
193. By purposefully severely recklessly ignoring its knowledge of impaired stores, including its own profit and loss reports for stores on an individual location basis, AFC violated these GAAP provisions. AFC has since restated to correct this improper accounting.

194. The failure to write down the value of impaired long-lived assets in a timely manner enabled AFC to understate expenses by $0.3 million in 2000 and $8.4 million in 2001. 2002 expenses were decreased in the restatement as those expenses were adjusted back to 2001 and 2000.

10. **AFC Failed to Properly Account for Inventory**

195. AFC, at its Seattle Coffee subsidiary, improperly avoided taking charges in 2000 and 2001 to write down inventory for the impact of costing changes, inventory obsolescence issues, package design changes and a non-integrated inventory accounting system. Such expense avoidance was in violation of both GAAP and AFC’s own publicly stated policy. AFC did not publicly disclose this overvaluation of inventory until the third quarter of 2002 – when these adjustments became too large to be ignored. However, when AFC tried to squeeze more than two years’ worth of these inventory adjustments into the financial statements for the third quarter of 2002, KPMG, upon discovering this, made them
appropriately reverse the adjustment and restate the adjustment back to 2001 and 2000, where it belonged.

196. Inventory improprieties of this magnitude could not continue to go on year after year without knowledge or severely reckless disregard. The 2001 inventory adjustment alone was $1.8 million, representing approximately 11% of the total consolidated inventory balance for the entire company as of 12/30/01 (not just Seattle Coffee). The $1.8 million in overstated Seattle Coffee inventory as a percentage of Seattle Coffee’s own inventory balance was so large that, had AFC properly written down the inventory, it would have been impossible for investors to ignore, particularly given the fact that the total improper overstatement at that date would have also been further inflated by the already existing $0.7 million inflation from 2000, which represented approximately 5% of AFC’s entire consolidated inventory balance at the end of 2000. At best, management was reckless in failing to make the required inventory write off in a timely manner.

197. ARB No. 43, Chapter 4, Statement 5 requires excess and obsolete inventory to be written down as a charge against income in the period in which it occurs. Specifically, ARB 43, Ch. 4, Stmt. 5 states:

Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current
period. This is generally accomplished by stating such goods at a lower level commonly designated as market...Thus, in accounting for inventories, a loss should be recognized whenever the utility of goods is impaired...

198. Despite the fact that AFC’s SEC filings stated that its policy was to state inventories “at the lower of cost (determined on a first-in, first-out basis) or market,” AFC did not make the required adjustment.

199. By failing to write down the value of its impaired inventory in a timely fashion, Defendants knew or recklessly disregarded that AFC violated GAAP and its own stated policy. Consequently, AFC understated its expenses in 2000 and 2001 by $0.7 million and $1.8 million, respectively. AFC has since restated to correct this improper accounting.

11. **AFC Failed to Adequately Accrue Liabilities**

200. AFC violated GAAP by failing to adequately accrue expenses for liabilities relating to business insurance, employee relocations, advertising, management bonuses and other miscellaneous accounts in a timely manner. The most basic accounting requires such items to be recorded in the period they are incurred. See CON 5 ¶¶85-87. For example, basic accrual accounting makes it clear that management bonuses, which are typically given based on prior performance during the year, should be expenses in the period that they were earned.
201. As a result of the improper accounting techniques, AFC’s expenses were understated by $1.0 million and $0.7 million in 2000 and 2001, respectively. AFC was forced to correct this improper accounting in its restatement.

12. **AFC Improperly Capitalized Interest**

202. AFC violated GAAP by capitalizing construction period interest on projects that were already completed. Under certain conditions, construction period interest is capitalized as part of the acquisition or construction cost of an asset. GAAP clearly dictates that interest may only be capitalized for assets in which construction is in progress (*i.e.*, during the period of time required to complete and prepare the asset for its intended use), and all other amounts should be expensed as interest expense in the period in which they are incurred. Specifically, GAAP states that “interest shall *not be capitalized for...*[assets that are in use or ready for their intended use]* in the earning activities of the enterprise.” *See FAS 34, Capitalization of Interest Cost, ¶10*, emphasis added. However, AFC chose to ignore this basic rule governing capitalizing interest, and capitalized the interest on its already-completed projects anyway.

203. AFC has since been forced to restate this improper accounting. As a result of improperly capitalizing interest, AFC was able to reduce its expenses by
$0.4 million, $0.9 million and $0.1 million in 2000, 2001 and the first three quarters of 2002, respectively.

13. **AFC Improperly Accounted for Rebates**

204. AFC violated GAAP by recording rebates from beverage vendors in the periods in which they were received rather than in the periods in which they were earned, thereby understating expenses and overstating earnings in 2001 and 2002. This is in violation of the matching principle of accounting. Accrual accounting requires the matching of related revenues and expenses to reflect an entity’s performance during a period instead of merely listing its cash receipts and outlays. See CON 6 ¶¶145-146, CON 5 ¶86. Consequently, AFC’s expenses were understated by $0.8 million and $0.2 million in 2001 and the first three quarters of 2002, respectively. AFC has since restated its financial statements to correct his improper accounting.

14. **AFC Used Unsupportable Rental Income Projections**

205. AFC violated GAAP by recording lease obligation expense for closed stores net of *anticipated* sublease rental income it hoped to secure. However, GAAP provides no supportable basis for reducing rent expense by “hopeful estimates” of potential future sublease rental income, and as such, AFC should not have improperly reduced its lease obligations by the estimated amounts. GAAP
generally prohibits the recording of such gain contingencies: "Contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization." See FAS 5, Accounting for Contingencies, ¶17a. In conjunction with that, GAAP also requires that, in response to uncertainty, the general tendency in accounting should be to apply conservative procedures in accounting recognition. See CON 5 ¶50. AFC did the opposite by recording the contingent income. Finally, even if a sublease has been entered into, FAS 13 requires lessees to continue to account for the full obligation related to the original lease as it had been doing prior to the sublease.

206. As a result of the improper inclusion of unsupportable possible future income, AFC understated its expenses by $1.3 million and $0.4 million in 2000 and the first three quarters of 2002, respectively. AFC has since restated its financial statements to correct this improper accounting.

15. **AFC Failed to Consolidate Advertising Funds**

207. AFC maintains cooperative advertising funds that receive contributions separately from Popeye’s and Church’s franchisees, whereby the franchisees and the Company contribute amounts to be used throughout the year for advertising for the respective brands. AFC violated GAAP by failing to consolidate the Popeye’s and Church’s advertising funds in the Company’s
financial statements, despite having control over the funds and how they were spent. AFC admitted that these accounts should have been consolidated in accordance with FAS 45, Accounting for Franchise Fee Revenue, and restated the improper accounting.

208. As a result of AFC’s failure to consolidate these advertising funds, AFC’s pre-tax income was overstated by $0.3 million in 2000 and $0.4 million in 2001. AFC has since restated its financial statements to correct this improper accounting.

16. **AFC Improperly Recorded Accruals**

209. AFC improperly recorded several expense accruals in 1999. For example, AFC understated its legal reserves in 1999 by $1.5 million and overstated its workers’ compensation and group medical accruals by $2.3 million in total. Then, in 2000, to cover the earlier improper accruals, AFC attempted to fix all three accruals by washing them through the 2000 accounting period. The adjustments resulted in a net artificial boost of $0.8 million to income in 2000. This trick improperly improved by approximately 3% their 2000 earnings figure that was included in the IPO Prospectus.

210. In its restatement, AFC was forced to reverse these adjustments improperly recorded in 2000 and instead properly record them in 1999, the net
impact of which was to reduce pre-tax income by $0.8 million in 2000. As a result of the manipulation of its accrued liabilities accounts, AFC had therefore overstated pre-tax income by $0.8 million in 2000.

17. AFC Lacked Adequate Internal Controls

211. Notwithstanding the allegations above, and the indicators of scienter alleged herein, AFC was grossly reckless in maintaining inadequate internal accounting controls. In fact, AFC stated that its auditor, its audit committee and the audit committee’s investigation concluded that there were significant control deficiencies that constituted material weaknesses in the Company’s control environment. See Ex. 99.4 to the 12/15/03 Form 8-K. Moreover, AFC ultimately disclosed in its 2002 Form 10-K that it began implementing no less than fifteen actions during 2003 necessary to bring internal controls to an adequate level.

212. In the 2002 10-K, the Company explicitly admitted that:

In connection with their audits of our financial statements for 2002, 2001 and 2000, KPMG assessed the internal controls of AFC and our subsidiaries and advised our Audit Committee that certain identified deficiencies constituted material control weaknesses. In their

\[14\] AU 319.06, Internal Control in a Financial Statement Audit, defines internal controls as “a process – effected by an entity’s board of directors, management, and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.
communications with our Audit Committee, KPMG stated that the more significant deficiencies were:

- inadequate and untimely resolution of balance sheet account reconciliation discrepancies,
- absence of appropriate reviews and approvals of transactions and accounting,
- inadequate procedures for appropriately assessing and applying accounting principles, and
- failure of identified controls in preventing or detecting misstatements of accounting information.

213. In addition, AFC’s Audit Committee concluded that the Company’s accounting, financial reporting and internal control functions needed significant improvement, including our system of documenting transactions. The Audit Committee further concluded that our internal technical accounting expertise was weak, and that enhanced training, staffing and discipline in the accounting and internal audit areas were needed.

214. Section 13(b)(2) of the Exchange Act states, in pertinent part, that every reporting company must: “(A) make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and (B) devise and maintain a system of internal controls sufficient to provide reasonable assurances that ... transactions are recorded as necessary ... to permit the preparation of financial statements in conformity with [GAAP].” These provisions require an issuer to employ and supervise reliable personnel, to maintain reasonable assurances that transactions
are executed as authorized, to properly record transactions on an issuer’s books and, at reasonable intervals, to compare accounting records with physical assets. 


215. AFC violated §13(b)(2)(A) of the Exchange Act by failing to maintain accurate records concerning its revenues, costs and net income. It failed to record expenses in the periods incurred and failed to defer certain gains on conversions. AFC’s inaccurate and false records were not isolated or unique instances because they were improperly maintained for multiple reporting periods, from 1998 through the third quarter of 2002. Accordingly, AFC violated §13(b)(2)(A) of the Exchange Act.

216. In addition, AFC violated §13(b)(2)(B) of the Exchange Act by failing to implement procedures reasonably designed to prevent accounting irregularities. AFC failed to ensure that proper review and checks were in place to ensure that it was recording and reporting expenses in the proper periods and that it was properly recognizing gains on store sales.

18. **Other GAAP Violations**

217. In addition to the GAAP and SEC violations described above, the Company also violated several additional fundamental GAAP principles:
i. The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

ii. The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB CON No. 1, ¶34);

iii. The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB CON No. 1, ¶40);

iv. The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB CON No. 1, ¶50);

v. The principle that financial reporting should provide information about an enterprise’s financial performance during a period was
violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors’ expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB CON No. 1, ¶42):

vi. The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB CON No. 2, ¶¶58-59);

vii. The principle of completeness, which means that no information is omitted that may be necessary to ensure that the Financial Statements validly represent underlying events and conditions, was violated (FASB CON No. 2, ¶79); and

viii. The principle that conservatism be used as a prudent reaction to uncertainty in order to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB CON No. 2, ¶¶95, 97).
218. Further, the undisclosed adverse information concealed by Defendants during the Class Period is the type of information that, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information that is expected to be and must be disclosed.

E. ADDITIONAL SCIENTER ALLEGATIONS

1. **Defendants’ Insider Selling Was Unusual In Timing And Amount**

219. In addition to the indicators of scienter discussed in ¶ 238, the scienter of the AFC Defendants sued for fraud is further evidenced by the large amount of insider selling, unusual in both timing and amount. According to Form 4s, the IPO Prospectus and the April 2002 Proxy, these Defendants and other AFC insiders sold the following amounts of stock:

<table>
<thead>
<tr>
<th>AFC ENTERPRISES</th>
<th>Summary of Class Period Insider Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insider</td>
<td>Shares Sold</td>
</tr>
<tr>
<td>Belatti</td>
<td>438,000</td>
</tr>
<tr>
<td>Holbrook</td>
<td>311,740</td>
</tr>
<tr>
<td>Frankel</td>
<td>172,500</td>
</tr>
<tr>
<td>Jon Luther</td>
<td>65,300</td>
</tr>
<tr>
<td>Hala Modelmog</td>
<td>103,115</td>
</tr>
<tr>
<td>Freeman Spogli &amp; Co.</td>
<td>6,624,000</td>
</tr>
</tbody>
</table>
The unusual timing and amount of these insiders' stock sales did not go unnoticed. For example, with respect to Pennington’s sales, an April 2003 article entitled “Stock sold before AFC ‘bombshell’” published in the *Atlanta Business Chronicle*, stated:

A board member of AFC Enterprises Inc. who serves on the company’s audit committee also controls an investment firm that sold $18 million worth of AFC stock back to the company last November, four months before the Company dropped its March 24 bombshell that it would restate earnings for 2001 and much of 2002, records show. The AFC board member, Kelvin J. Pennington, 43, is a general partner of Penman Asset Management L.P., the general partner of Penman Private Equity and Mezzanine Fund L.P. On Nov. 26, AFC said that it purchased 838,637 shares of AFC stock held by Penman Private Equity and Mezzanine Fund for $21.65 per share, or $18.1 million.

* * *

AFC . . . announced March 24 it would have to restate its earnings for 2001 and three quarters of 2002 because of accounting questions. Analysts described the announcement as a “bombshell” that fried AFC’s credibility on Wall Street. . . [A]nalysts grilled Wilkins and . . . Belatti about the Penman fund stock sale and the accounting restatements in a March 25 conference call. One analyst asked if the [SEC] had “expressed a concern or displeasure over that [Pennington] transaction as yet?”
The unusual amount of these sales, where Defendants disposed of as much as 100% of their holdings is shown below:

2. Defendants Pennington and Figel's Severe Recklessness Is Further Evidenced By Their Inclusion on AFC's Audit Committee During the Class Period

Defendants Pennington and Figel were intimately aware of AFC's false financial reporting due to their integral role in formulating and reviewing AFC's accounting practices due to their inclusion on the Company's Audit Committee. The Audit Committee met at least four times during 2001, and was charged with "oversee[ing] the Company’s financial reporting process on behalf of the Board of Directors." See, 2002 Proxy Statement, Audit Committee Charter.
According to the 2002 AFC’s Proxy Statement, with respect to the audited financial statements for fiscal year 2001, Defendants Pennington and Figel:

- Reviewed and discussed the audited financial statements with AFC’s management;
- Discussed the financial statements with Arthur Andersen LLP as required by SAS No. 61;\(^{15}\)
- Met with Arthur Andersen and AFC management to review the scope of the proposed audit for 2001 and the audit procedures to be utilized;
- Reviewed with Arthur Andersen AFC’s financial management, the adequacy and effectiveness of the accounting and financial controls of the Company; and
- Reviewed with management and the auditors the financial information contained in the Company’s 10-Qs prior to filing, the Company’s earnings announcements prior to release, as well as the annual consolidated financial statements and related footnotes.

223. According to AFC’s Audit Committee Charter, these Defendants were expressly charged with providing assistance to the Board of Directors in fulfilling its oversight responsibility to the Company’s stockholders relating to:

- financial systems and financial reporting process;
- systems of internal accounting and financial controls;
- internal audit function;

\(^{15}\) Statement on Auditing Standards No. 61 requires the audit committee to exercise oversight over financial reporting as well as the scope and results of the audit.
• annual independent audit of its financial statements; and
• legal compliance and ethics programs, as established by management and the Board.

224. The 2002 Proxy Statement demonstrated that these Defendants specifically endorsed the public dissemination of the false financial statements, noting that:

Based upon these discussions with management and the independent accountants, the Audit Committee recommended to the Board of Directors that the audited financial statements for AFC be included in AFC's Annual Report on Form 10-K for the fiscal year ended December 30, 2001 for filing with the SEC.

3. Cooking The Books to Meet Analysts' Estimates

225. Throughout the Class Period, meeting Wall Street's quarterly expectations for the Company was crucial for Defendants.

226. As discussed in detail above, it was essential for the Company to foster and maintain publicly the illusion of being a high-growth company. As set forth herein, Defendants falsified their financial results during the Class Period, among other reasons, to create the illusion that AFC was meeting analysts' expectations. As set forth below, the Company's reported financial figures met or exceeded analysts' consensus estimates in nearly every quarter during the Class Period. If the Defendants had reported the Company's financial results in
accordance with GAAP, AFC would have missed analysts' estimates in all but one quarter during the Class Period, as shown in the chart below:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Actual EPS$^{16}$</th>
<th>Analyst Consensus EPS</th>
<th>Restated EPS$^{17}$</th>
<th>% By Which Forecast Was Missed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2001</td>
<td>$0.27</td>
<td>$0.26</td>
<td>$0.13</td>
<td>50%</td>
</tr>
<tr>
<td>Q2 2001</td>
<td>0.28</td>
<td>0.27</td>
<td>0.18</td>
<td>33%</td>
</tr>
<tr>
<td>Q3 2001</td>
<td>0.29</td>
<td>0.28</td>
<td>0.19</td>
<td>32%</td>
</tr>
<tr>
<td>Q4 2001</td>
<td>0.37</td>
<td>0.36</td>
<td>0.03</td>
<td>92%</td>
</tr>
<tr>
<td>Q1 2002</td>
<td>0.40</td>
<td>0.40</td>
<td>0.46</td>
<td>-15%</td>
</tr>
<tr>
<td>Q2 2002</td>
<td>0.40</td>
<td>0.40</td>
<td>0.28</td>
<td>30%</td>
</tr>
<tr>
<td>Q3 2002</td>
<td>0.39</td>
<td>0.39</td>
<td>0.31</td>
<td>21%</td>
</tr>
</tbody>
</table>

4. **Defendants' Enormous Cash Bonuses Provided Additional Incentive To Mislead Investors**

227. Defendants were strongly motivated to turn a blind eye to the severity of the accounting improprieties and manipulation because of the potential to earn stock appreciation rights ("SARs")$^{18}$ as well as cash bonuses equal to 300% of

$^{16}$ Diluted EPS excluding losses from change in accounting principle and extraordinary losses on early extinguishment of debt.

$^{17}$ Q3 2002 Actual & Consensus EPS figures exclude charges for the write down of inventory and leasehold improvements at the Seattle Coffee Company division.

$^{18}$ As defined in the 2002 Proxy Statement, SARS are rights to receive the appreciation in the fair market value of a share of AFC common stock from the date the SAR was granted. Upon the exercise of a SAR, the SAR holder will receive an amount in cash, stock or both, equal in value to the excess of the fair
their base salaries under AFC’s Annual Executive Bonus Program. Under the bonus program, if AFC achieved certain predetermined annual and quarterly performance goals, including the achievement of stock price appreciation goals, Defendants and certain Company executives would receive a bonus. As detailed in the Company’s 2002 Proxy Statement, the following business criteria were utilized to determine the bonuses:

(1) our return over capital costs or increases in our return over capital costs; (2) our system-wide sales or the growth in system-wide sales; (3) our total earnings or the growth in total earnings; (4) our consolidated earnings or the growth in consolidated earnings; (5) our earnings per share or the growth in earnings per share; (6) our net earnings or the growth in net earnings; (7) our earnings before interest expense, taxes, depreciation, amortization and other non-cash items or the growth in such earnings; (8) our earnings before interest and taxes or the growth in such earnings; (9) our consolidated net income or the growth in consolidated net income; (10) the value of our common stock or the growth in such value; (11) our stock price or the growth in our stock price; (12) our return assets or the growth in return on assets; (13) our cash flow or the growth in cash flow; (14) our total market value on the date of exercise over the price per share specified in the related grant certificate, multiplied by the number of shares for which the SAR is exercised. Since Defendants received significant amounts of performance-based stock options, they were strongly motivated to artificially inflate the value of AFC’s stock price to reap these stock-based rewards.

19 Prior to August 2001, the Board of Directors that included nearly all of the Individual Defendants determined the bonuses. After August 2001, the bonuses were determined by the “People Services Committee,” which consisted of Victor Arias, Jr. and Defendants Roth and Pennington.
shareholder return or the growth in total shareholder return; (15) our expenses or the reduction of our expenses.

228. If these criteria were met, the Individual Defendants would receive enormous bonuses. As specified in the 2002 Proxy Statement:

The maximum annual bonus payable under the program to any participant for any fiscal year is 300% of the base salary that is paid to such participant in such fiscal year or $3,000,000, whichever is less.

229. As detailed in the 2002 Proxy Statement, Defendants and certain other Company executives did, in fact, receive significant performance based bonuses based on the issuance of AFC's false financial results.

<table>
<thead>
<tr>
<th>Name and Principal Position</th>
<th>Year</th>
<th>Salary</th>
<th>Bonus (1)</th>
<th>Securities Underlying Options</th>
<th>All Other Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Long Term Compensation</td>
<td></td>
</tr>
<tr>
<td>Frank J. Bellatti</td>
<td>2001</td>
<td>$574,000</td>
<td>$382,812</td>
<td>60,000</td>
<td>$18,360</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>529,328</td>
<td>432,500</td>
<td>33,333</td>
<td>18,360</td>
</tr>
<tr>
<td>Dick R. Holbrook</td>
<td>2001</td>
<td>$424,999</td>
<td>$285,812</td>
<td>46,666</td>
<td>$6,395</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>376,422</td>
<td>245,000</td>
<td>26,666</td>
<td>6,935</td>
</tr>
<tr>
<td>Gerald J. Wilkins</td>
<td>2001</td>
<td>$350,000</td>
<td>$362,359</td>
<td>40,531</td>
<td>$22,414</td>
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<tr>
<td></td>
<td>2000</td>
<td>325,481</td>
<td>200,000</td>
<td>20,000</td>
<td>5,510</td>
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<tr>
<td>Samuel N. Frankel</td>
<td>2001</td>
<td>$330,000</td>
<td>$155,941</td>
<td>16,666</td>
<td>$123,995</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>332,885</td>
<td>179,300</td>
<td>20,000</td>
<td>14,495</td>
</tr>
<tr>
<td>Jon Luther</td>
<td>2001</td>
<td>$339,000</td>
<td>$271,857</td>
<td>33,333</td>
<td>$14,544</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>319,962</td>
<td>175,000</td>
<td>13,333</td>
<td>14,544</td>
</tr>
<tr>
<td>Hala Moddelmog</td>
<td>2001</td>
<td>$339,999</td>
<td>$113,156</td>
<td>30,000</td>
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<tr>
<td></td>
<td>2000</td>
<td>324,692</td>
<td>100,000</td>
<td>16,666</td>
<td>3,010</td>
</tr>
</tbody>
</table>

230. During 2002, Belatti received a base salary of $575,000 as well as an incentive cash bonus of $181,750, and a stock option award of 120,000 shares.
Wilkins received a severance package of $647,000 payable over a two-year period, as well as a consulting agreement (worth $129,550), that additionally accelerated the vesting of 5,000 stock options with a strike price of $13.13 per share, 20,266 stock options with a strike price of $15.00 per share, and 39,375 stock options with a strike price of $28.01 per share. Additionally, Mr. Wilkins was provided additional benefits with an estimated value of $37,000.

F. NO STATUTORY SAFE HARBOR

231. The federal statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this Complaint. Further, none of the statements pleaded herein which were forward-looking statements were identified as “forward-looking statements” when made. Nor was it stated that actual results “could differ materially from those projected.” Nor were the forward-looking statements pleaded accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from the statements made therein. Defendants are liable for the forward-looking statements pleaded because, at the time each of those forward-looking statements was made, the speaker knew the forward-looking statement was false and the forward-looking statement was authorized and/or approved by an executive officer of AFC who knew that those
statements were false when made. Moreover, pursuant to 15 U.S.C. § 77z-2(b)(i)(B), the Safe Harbor does not apply to statements made in connection with a public offering such as the IPO in this case, and pursuant to 15 U.S.C. § 77z-2(b)(2)(A), the Safe Harbor does not apply to information included in a financial statement prepared in accordance with GAAP.

**COUNT III**

FOR VIOLATIONS OF SECTION 10(b) OF THE 1934 ACT AND RULE 10B-5 PROMULGATED THEREUNDER AGAINST AFC, BELATTI, WILKINS, HOLBROOK AND PENNINGTON

232. Plaintiffs repeat and reallege the allegations set forth in paragraphs 1 to 231 as though fully set forth herein. This claim is asserted against Defendants AFC, Belatti, Wilkins, Holbrook and Pennington (the “Section 10(b) Defendants”).

233. During the Class Period, Section 10(b) Defendants carried out a plan, scheme and course of conduct which was intended to, and did: (i) deceive the investing public, including Plaintiffs and other Class members, as alleged herein; (ii) artificially inflate and maintain the market price of AFC common stock; and (iii) cause Plaintiffs and other members of the Class to purchase AFC stock at artificially inflated prices during the Class Period. In furtherance of this unlawful scheme, plan and course of conduct, the Section 10(b) Defendants, and each of them, took the actions set forth herein.
234. These Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices and a course of business which operated as a fraud and deceit upon the purchasers of the Company’s common stock in an effort to maintain artificially high market prices for AFC common stock in violation of Section 10(b) of the Exchange Act and Rule 10b-5. These Defendants are sued as primary participants in the wrongful and illegal conduct charged herein. These Defendants are also sued herein as controlling persons of AFC, as alleged below.

235. In addition to the duties of full disclosure imposed on Defendants as a result of their making of affirmative statements and reports, or participation in the making of affirmative statements and reports to the investing public, they each had a duty to promptly disseminate truthful information that would be material to investors in compliance with the integrated disclosure provisions of the SEC as embodied in SEC Regulation S-X (17 C.F.R. § 210.01 et seq.) and S-K (17 C.F.R. § 229.10 et seq.) and other SEC regulations, including accurate and truthful information with respect to the Company’s operations, financial condition and performance so that the market prices of the Company’s publicly-traded securities would be based on truthful, complete and accurate information.
236. The Section 10(b) Defendants, individually and in concert, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, business practices, performance, operations and future prospects of AFC as specified herein. These Defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of AFC’s value and performance and substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about AFC and its business, operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of AFC securities during the Class Period.

237. The primary liability and controlling person liability of these Defendants arises from the following facts: (i) Belatti, Wilkins, Holbrook and Pennington were all high-level executives and/or directors at the Company during
the Class Period; (ii) each of these Defendants, by virtue of his responsibilities and activities as a senior executive officer and/or director of the Company, was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii) the Individual Defendants enjoyed significant personal contact and familiarity with each other and were advised of and had access to other members of the Company's management team, internal reports, and other data and information about the Company's financial condition and performance at all relevant times; and (iv) these Defendants were aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

238. The Section 10(b) Defendants had actual knowledge of the severe misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were readily available to them. Such Defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing AFC's operating condition, business practices and future business prospects from the investing public and supporting the artificially inflated price of its stock. As demonstrated by their overstatements and misstatements of the Company's financial condition and performance
throughout the Class Period, the Individual Defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

239. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of AFC’s common stock was artificially inflated during the Class Period. In ignorance of the fact that the market price of AFC’s shares was artificially inflated, and relying directly or indirectly on the false and misleading statements made by the Section 10(b) Defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by these Defendants but not disclosed in public statements by these Defendants during the Class Period, Plaintiffs and the other members of the Class acquired AFC common stock during the Class Period at artificially inflated high prices and were damaged thereby.

240. At the time of said misrepresentations and omissions, Plaintiffs and other members of the Class were ignorant of their falsity, and believed them to be true. Had Plaintiffs and the other members of the Class and the marketplace known of the true performance, business practices, future prospects and intrinsic
value of AFC, which were not disclosed by these Defendants, Plaintiffs and other members of the Class would not have purchased or otherwise acquired their AFC securities during the Class Period, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

241. By virtue of the foregoing, AFC, Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, and Kelvin Pennington each violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

242. As a direct and proximate result of the Section 10(b) Defendants’ wrongful conduct, Plaintiffs and the other members of the Class suffered damages in connection with their purchases of the Company’s securities during the Class Period.

COUNT IV

FOR VIOLATIONS OF SECTION 20(a) OF THE 1934 ACT AGAINST FRANK BELATTI, GERALD J. WILKINS, DICK R. HOLBROOK, KELVIN PENNINGTON, JOHN M. ROTH, RONALD P. SPOGLI, FREEMAN SPOGLI & CO. INC AND PENMAN PRIVATE EQUITY AND MEZZANINE FUND, L.P.

243. Plaintiffs repeat and reallege the allegations set forth in paragraphs 1 to 242 above as if set forth fully herein. This claim is asserted against Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth,

244. Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. were and acted as controlling persons of AFC within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions with the Company, participation in and/or awareness of the Company’s operations and/or intimate knowledge of the Company’s actual performance, these Defendants had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the dissemination of the various statements which Plaintiffs contend are false and misleading. Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. were provided with or had unlimited access to copies of the Company’s reports, press releases, public filings and other statements alleged by Plaintiffs to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.
245. In addition, Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. had direct involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

246. As set forth above, Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their controlling positions, Frank Belatti, Gerald J. Wilkins, Dick R. Holbrook, Kelvin Pennington, John M. Roth, Ronald P. Spogli, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of these Defendants’ wrongful conduct, Plaintiffs and other members of the Class suffered damages in connection with their purchases of the Company’s securities during the Class Period.
COUNT V

VIOLATION OF SECTION § 20A OF THE EXCHANGE ACT (AGAINST FRANK BELATTI, DICK R. HOLBROOK, SAMUEL N. FRANKEL, FREEMAN SPOGLI & CO. INC., AND PENMAN PRIVATE EQUITY AND MEZZANINE FUND, L.P.)

247. Plaintiffs repeat and reallege each and every allegation contained above. This claim is asserted against Defendants Frank Belatti, Dick R. Holbrook, Samuel N. Frankel, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P.

248. Defendants Frank Belatti, Dick R. Holbrook, Samuel N. Frankel, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P., by virtue of their positions as AFC Officers and/or Directors, had access to, and were in possession of, material non-public information about AFC at the time of their sales of 9,098,377 shares of AFC stock for proceeds of $209,467,573.00 during the Class Period.

249. By virtue of their participation in the scheme to defraud investors described herein and their sales of stock while in possession of material non-public information about AFC, Defendants Frank Belatti, Dick R. Holbrook, Samuel N. Frankel, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P. violated § 10(b) of the Exchange Act and applicable rules and regulations thereunder.

251. Lead Plaintiff Local 132 and all other members of the Class who purchased shares of AFC stock contemporaneously with sales of AFC stock by Defendants Frank Belatti, Dick R. Holbrook, Samuel N. Frankel, Freeman Spogli & Co. Inc., and PENMAN Private Equity and Mezzanine Fund, L.P.: (a) have suffered substantial damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for AFC stock as a result of the violations of § 10(b) and Rule 10b-5 herein; and (b) would not have purchased AFC securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by these Defendants’ misleading statements and concealment of material facts. At the time of the purchases by Lead Plaintiff Local 132 and Class Members, the fair market value of the AFC securities was substantially less than the price paid for them.
VI. CLASS ACTION ALLEGATIONS

A. GENERAL

252. Plaintiffs bring this action as a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of a class (the “Class”) consisting of all persons who purchased the common stock of AFC between March 2, 2001 and March 24, 2003, inclusive (the “Class Period”), including those who purchased AFC shares pursuant or traceable to the Company’s Registration Statement and Prospectus for its March 2, 2001 IPO of 10,781,250 shares of common stock at $17 per share and the December 6, 2001 Secondary Offering of an additional 7,000,000 shares at $23 per share. Excluded from the Class are the Defendants herein, members of each Individual Defendant’s immediate family, any entity in which any Defendant has a controlling interest, and the legal affiliates, representatives, heirs, controlling persons, successors, and predecessors in interest or assigns of any such excluded party.

253. Because AFC has millions of shares of common stock outstanding, and because the Company’s common stock was actively traded on the NASDAQ National Markets during the Class Period, members of the Class are so numerous that joinder of all members is impracticable. As of November 30, 2003, AFC had 27,954,510 shares outstanding. While the exact number of Class members can
only be determined by appropriate discovery. Plaintiffs believe that Class members number at least in the thousands and that they are geographically dispersed.

254. Plaintiffs’ claims are typical of the claims of the members of the Class, because Plaintiffs and all of the Class members sustained damages arising out of Defendants’ wrongful conduct complained of herein.

255. Plaintiffs will fairly and adequately protect the interests of the Class members and have retained counsel who are experienced and competent in class and securities litigation. Plaintiffs have no interests that are contrary to or in conflict with the members of the Class Plaintiffs seek to represent.

256. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy, since joinder of all members is impracticable. Furthermore, as the damages suffered by individual members of the Class may be relatively small, the expense and burden of individual litigation make it impossible for the members of the Class individually to redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

257. Questions of law and fact common to the members of the Class predominate over any questions that may affect only individual members, in that
Defendants have acted on grounds generally applicable to the entire Class. Among the questions of law and fact common to the Class are:

i. whether the federal securities laws were violated by Defendants’ acts as alleged herein;

ii. whether the Registration Statement and Prospectus for the March 2, 2001 and December 6, 2001 secondary public offering contained material misstatements or omissions;

iii. whether the Company’s other publicly disseminated releases and statements during the Class Period omitted and/or misrepresented material facts and whether Defendants breached any duty to convey material facts or to correct material facts previously disseminated;

iv. whether Defendants participated in and pursued the fraudulent scheme or course of business complained of;

v. whether the Defendants acted willfully, with knowledge or recklessly, in omitting and/or misrepresenting material facts;

vi. whether the market prices of AFC common stock during the Class Period were artificially inflated due to the material nondisclosures and/or misrepresentations complained of herein; and
vii. whether the members of the Class have sustained damages and, if so, what is the appropriate measure of damages.

B. APPLICABILITY OF PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET DOCTRINE

258. Plaintiffs will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that, among other things:

(a) Defendants made public misrepresentations or failed to disclose facts during the Class Period;

(b) The omissions and misrepresentations were material;

(c) AFC securities traded in an efficient market;

(d) The misrepresentations alleged would tend to induce a reasonable investor to misjudge the value of the Company’s securities; and

(e) Plaintiffs and the other members of the Class purchased AFC securities between the time Defendants misrepresented or failed to disclose material facts and the time the true facts were disclosed, without knowledge of the misrepresented or omitted facts.

259. At all relevant times, the market for AFC securities was an efficient market for the following reasons, among others:

(a) AFC securities were listed and actively traded during the Class Period on the NASDAQ exchange, an open, highly efficient and automated
market. The average daily volume of the AFC’s common stock during the Class Period was 240,351 shares based on information from the Yahoo Finance website. The total number of shares traded during the Class Period was 122,819,500 shares;

(b) As a regulated issuer, AFC regularly made public filings, including its Forms 10-K, Forms 10-Q and related press releases, with the SEC. Additionally, AFC met the eligibility requirements for filing a SEC Form S-3 Registration Statement and in fact filed such a statement on April 25, 2002;

(c) AFC was followed by analysts from major brokerages including Bear Stearns, CIBC World Markets Corp., Smith Barney Citigroup, Credit Suisse First Boston, and SG Cowen Securities Inc. The reports of these analysts were redistributed to the brokerages’ sales force, their customers, and the public at large; and

(d) AFC regularly communicated with public investors via established market communication mechanisms, including the Company’s website, regular disseminations of press releases on the major news wire services, and other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services.

260. As a result, the market for AFC securities digested current information regarding the Company from the publicly available sources described
above and reflected such information in the prices of AFC’s securities. As would be expected where a security is traded in an efficient market, material news concerning AFC’s business had an immediate effect on the market price of AFC’s securities, as evidenced by the rapid decline in the market price in the immediate aftermath of AFC’s corrective disclosures as described herein. Under these circumstances, all purchasers of AFC’s securities during the Class Period suffered similar injury due to the fact that the price of AFC securities was artificially inflated throughout the Class Period. At the times they purchased or otherwise acquired AFC’s securities, Lead Plaintiffs and other members of the Class were without knowledge of the facts concerning the wrongful conduct alleged herein and could not reasonably have discovered those facts. As a result, the presumption of reliance applies. Plaintiffs will also rely, in part, upon the presumption of reliance established by a material omission.

VII. PRAYER FOR RELIEF

WHEREFORE, Plaintiffs, on their own behalf and on behalf of the Class, pray for judgment as follows:

A. Declaring this action to be a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of the Class defined herein;
B. Awarding Plaintiffs and the other members of the Class damages in an amount which may be proven at trial, together with interest thereon;

C. Awarding Plaintiffs and the members of the Class pre-judgment and post-judgment interest, as well as their reasonable attorneys’ and experts’ witness fees and other costs;

D. Ordering an accounting of Defendants’ insider trading proceeds;

E. Pursuant to Section 304 of the Sarbanes Oxley Act of 2002, 15 U.S.C. §7243, disgorge Defendants Belatti and Wilkins of all bonuses and profits gained from AFC stock sales earned in the twelve month period prior to each restated financial statement;

F. Awarding preliminary and permanent injunctive relief in favor of plaintiffs and the Class against Defendants, including an accounting of and the imposition of a constructive trust and/or an asset freeze on Defendants’ insider trading proceeds; and

G. Such other relief as this Court deems appropriate.

VIII. JURY DEMAND

Plaintiffs demand a trial by jury.
Date: January 26, 2004

Respectfully submitted,

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Co-Lead Counsel for Plaintiffs
### EXHIBIT A

<table>
<thead>
<tr>
<th>Confidential Witness</th>
<th>Position Held</th>
</tr>
</thead>
<tbody>
<tr>
<td>CW1</td>
<td>Former management-level employee during the Class Period in AFC's real estate division who worked directly on the conversions.</td>
</tr>
<tr>
<td>CW2</td>
<td>Former AFC Internal Audit Consultant employed between 2000 and 2003.</td>
</tr>
<tr>
<td>CW3</td>
<td>Former ACF employee in the Company's IT department employed during the Class Period.</td>
</tr>
<tr>
<td>CW4</td>
<td>Former AFC Vice President employed from 1999 through December 2002.</td>
</tr>
<tr>
<td>CW5</td>
<td>Former Vice President employed at Popeye's during the Class Period.</td>
</tr>
<tr>
<td>CW6</td>
<td>Former Seattle Coffee Credit Department employed who worked for Seattle Coffee during the Class Period.</td>
</tr>
<tr>
<td>CW7</td>
<td>Former Vice President employed by Seattle Coffee during the Class Period.</td>
</tr>
</tbody>
</table>
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served by U.S. Mail, postage prepaid, this 26th day of January, 2004, upon all co-counsel listed on the attached Service List; and upon defense counsel by hand delivery.

By: Edward H. Nicholson, Jr.
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