
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 27, 2007**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 000-29643

GRANITE CITY FOOD & BREWERY LTD.

(Exact Name of Registrant as Specified in Its Charter)

Minnesota
(State or Other Jurisdiction
of Incorporation or Organization)

41-1883639
(I.R.S. Employer
Identification No.)

**5402 Parkdale Drive, Suite 101
Minneapolis, Minnesota 55416
(952) 215-0660**
(Address of Principal Executive Offices and Issuer's
Telephone Number, including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of May 1, 2007, the issuer had outstanding 15,991,767 shares of common stock.

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PART I FINANCIAL INFORMATION**ITEM 1 Financial Statements**

GRANITE CITY FOOD & BREWERY LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
ASSETS:		
Current assets:		
Cash	\$12,385,804	\$ 7,671,750
Inventory	467,218	511,146
Prepays and other	456,163	393,803
Total current assets	<u>13,309,185</u>	<u>8,576,699</u>
Prepaid rent, net of current portion	488,802	503,267
Property and equipment, net	52,981,094	54,018,124
Intangible assets and other	725,892	760,420
Total assets	<u>\$67,504,973</u>	<u>\$63,858,510</u>
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 1,848,298	\$ 2,289,433
Accrued expenses	3,905,987	5,104,730
Deferred rent, current portion	135,729	143,928
Long-term debt, current portion	270,744	259,940
Capital lease obligations, current portion	933,420	1,885,388
Total current liabilities	<u>7,094,178</u>	<u>9,683,419</u>
Deferred rent, net of current portion	1,680,370	1,603,557
Long-term debt, net of current portion	1,934,147	2,004,986
Capital lease obligations, net of current portion	<u>32,164,280</u>	<u>37,501,605</u>
Total liabilities	<u>42,872,975</u>	<u>50,793,567</u>
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.01 par value, 90,000,000 shares authorized; 15,987,665 and 13,370,331 shares issued and outstanding at March 27, 2007 and December 26, 2006, respectively	159,877	133,703
Additional paid-in capital	42,062,661	29,122,306
Accumulated deficit	<u>(17,590,540)</u>	<u>(16,191,066)</u>
Total shareholders' equity	<u>24,631,998</u>	<u>13,064,943</u>
Total liabilities and shareholders' equity	<u>\$67,504,973</u>	<u>\$63,858,510</u>

See notes to condensed consolidated financial statements.

GRANITE CITY FOOD & BREWERY LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	<u>Thirteen Weeks Ended</u>	
	<u>March 27, 2007</u>	<u>March 28, 2006</u>
Restaurant revenues	\$18,182,192	\$11,892,319
Cost of sales:		
Food, beverage and retail	5,394,722	3,514,935
Labor	6,606,903	4,266,821
Direct restaurant operating	2,442,939	1,594,651
Occupancy	1,171,544	681,655
Total cost of sales	<u>15,616,108</u>	<u>10,058,062</u>
Pre-opening	95,841	811,802
General and administrative	1,734,052	1,449,560
Depreciation and amortization	<u>1,120,323</u>	<u>752,456</u>
Operating loss	<u>(384,132)</u>	<u>(1,179,561)</u>
Interest:		
Income	32,476	32,050
Expense	<u>(1,045,565)</u>	<u>(498,029)</u>
Interest expense, net	<u>(1,013,089)</u>	<u>(465,979)</u>
Loss before income tax	(1,397,221)	(1,645,540)
Income tax provision	<u>(2,253)</u>	<u>(500)</u>
Net loss	<u><u>\$ (1,399,474)</u></u>	<u><u>\$ (1,646,040)</u></u>
Loss per common share, basic and diluted	<u><u>\$ (0.10)</u></u>	<u><u>\$ (0.12)</u></u>
Weighted average shares outstanding, basic and diluted	<u><u>13,945,569</u></u>	<u><u>13,226,526</u></u>

See notes to condensed consolidated financial statements.

GRANITE CITY FOOD & BREWERY LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	<u>Thirteen Weeks Ended</u>	
	<u>March 27, 2007</u>	<u>March 28, 2006</u>
Cash flows from operating activities:		
Net loss	\$ (1,399,474)	\$ (1,646,040)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,120,323	752,456
Stock option compensation expense	181,248	180,101
Loss/(gain) on disposal of asset	54,289	(3,873)
Deferred rent	68,614	202,403
Changes in operating assets and liabilities:		
Inventory	43,928	(58,893)
Prepays and other and prepaid rent	(47,895)	47,180
Accounts payable	(237,352)	151,297
Accrued expenses	(1,198,743)	(443,296)
Net cash used in operating activities	<u>(1,415,062)</u>	<u>(818,665)</u>
Cash flows from investing activities:		
Purchase of:		
Property and equipment	(367,617)	(2,416,940)
Intangible assets and other	(6,617)	(11,668)
Net cash used in investing activities	<u>(374,234)</u>	<u>(2,428,608)</u>
Cash flows from financing activities:		
Payments on capital lease obligations	(6,289,293)	(212,551)
Payments on long term-debt	(60,035)	(59,579)
Proceeds/(costs incurred) from issuance of stock	12,852,678	(4,181)
Net cash provided by (used in) financing activities	<u>6,503,350</u>	<u>(276,311)</u>
Net increase (decrease) in cash	4,714,054	(3,523,584)
Cash, beginning	7,671,750	9,836,231
Cash, ending	<u>\$ 12,385,804</u>	<u>\$ 6,312,647</u>
Supplemental disclosure of non-cash investing and financing activities:		
Land, buildings and equipment acquired under capital lease agreements	<u>\$ —</u>	<u>\$ 5,054,800</u>
Property and equipment, intangibles and stock issuance costs included in accounts payable and accrued expenses	<u>\$ 203,783</u>	<u>\$ 1,283,867</u>
Income taxes paid	<u>\$ 2,253</u>	<u>\$ 500</u>

See notes to condensed consolidated financial statements.

GRANITE CITY FOOD & BREWERY LTD.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Thirteen weeks ended March 27, 2007 and March 28, 2006

1. Summary of significant accounting policies

Background

Granite City Food & Brewery Ltd. (the "Company") develops and operates casual dining restaurants known as Granite City Food & Brewery®. The restaurant theme is upscale casual dining with a wide variety of menu items that are prepared fresh daily, combined with freshly brewed hand-crafted beers finished on-site. The first Granite City restaurant opened in St. Cloud, Minnesota in July 1999 and the Company subsequently expanded to other Midwest markets, bringing the total number of restaurants it operates to 18, while pursuing its national expansion plans. The Company also operates a beer production facility which is used to provide raw material support to its restaurants to create consistent quality and operational efficiencies.

The Company's expansion strategy focuses on development of restaurants in markets where management believes the Company's concept will have broad appeal and attractive restaurant-level economics.

Principles of consolidation and presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and regulations of the Securities and Exchange Commission. Accordingly, they do not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These statements include the accounts and operations of the Company and its subsidiary corporations under which its Kansas locations are operated. Fifty-one percent of the stock of each of the subsidiary corporations is owned by a resident of Kansas and the Company owns the remainder of the stock of each corporation. Each resident-owner of the stock of these entities has entered into a buy-sell agreement with each corporation providing, among other things, that transfer of the shares is restricted and that the shareholder must sell his shares to the corporation upon certain events, including termination of employment (if employed by the Company) or any event which disqualifies the resident-owner from owning the shares under applicable laws and regulations of the state. The Company has entered into a master agreement with each separate corporation that permits the operation of the restaurants and leases to each corporation the Company's property and facilities. Each corporation pays all of its operating expenses and obligations, and the Company retains, as consideration for the operating arrangements and the lease of property and facilities, the net profit from its operations. The Company has determined that the foregoing ownership structure will cause these separate corporations to be treated as variable interest entities in which the Company has a controlling financial interest for the purpose of FASB Interpretation 46 (R), *Consolidation of Variable Interest Entities* (FIN46R). As such, the corporations are consolidated with the Company's financial statements and the Company's financial statements do not reflect a minority ownership in those separate corporations. All references to the Company in these financial statements relate to the consolidated entity.

In the opinion of management, all adjustments, consisting of normal recurring adjustments, which are necessary for a fair statement of its financial position as of March 27, 2007 and the results of operations for the interim periods ended March 27, 2007 and March 28, 2006 have been included.

The balance sheet at December 26, 2006, has been derived from the audited financial statements at that date, but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements. Certain information and note disclosures normally included in the Company's annual financial statements have been condensed or omitted. These condensed financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report

on Form 10-K for the fiscal year ended December 26, 2006, filed with the Securities and Exchange Commission on February 21, 2007.

The results of operations for the thirteen weeks ended March 27, 2007 are not necessarily indicative of the results to be expected for the entire year.

Reclassification

Certain reclassifications have been made to the financial statements for the first quarter of 2006 in order for them to conform to the presentation of the financial statements for the first quarter of 2007. These reclassifications have no effect on the accumulated deficit or net loss previously reported.

Revenue recognition

Revenue is derived from the sale of prepared food and beverage and select retail items. Revenue is recognized at the time of sale and is reported on the Company's statement of operations net of sales taxes collected. Revenue derived from gift card sales is recognized at the time the gift card is redeemed. Until the redemption of gift cards occurs, the outstanding balances on such cards are included in accrued expenses in the accompanying consolidated balance sheets. The Company recognizes gift card breakage amounts based upon historical redemption patterns, which represent the balance of gift cards for which the Company believes the likelihood of redemption by the customer is remote.

Stock-based compensation

The Company records stock-based compensation in accordance with the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard ("SFAS") No. 123 (revised 2004) ("SFAS 123(R)"), *Share-Based Payment*, and SEC Staff Accounting Bulletin No. 107 ("SAB 107"), *Share-Based Payment*, requiring the measurement and recognition of all share-based compensation under the fair value method. The Company implemented SFAS 123(R) using the modified prospective method, effective December 28, 2005, the first day of its 2006 fiscal year.

Accounting for leases

The Company leases most of its restaurant properties. Leases are accounted for under the provisions of SFAS No. 13 and SFAS No. 98, *Accounting for Leases*, as well as other subsequent amendments and authoritative literature including FASB Staff Position No. FAS 13-1, *Accounting for Rental Costs Incurred During a Construction Period*. For leases that contain rent escalations, the Company records the total rent payable during the lease term on a straight-line basis over the initial lease term, including the "build-out" or "rent-holiday" period where no rent payments are typically due under the terms of the lease. Any difference between minimum rent and straight-line rent is recorded as deferred rent. Contingent rent expense, which is based on a percentage of revenue, is also recorded to the extent it exceeds minimum base rent per the lease agreement. Deferred rent also includes a tenant improvement allowance the Company received which is being amortized as a reduction of rent expense on a straight-line basis over the initial term of the lease.

Earnings (loss) per share

Basic loss per common share is calculated by dividing net loss by the weighted average number of common shares outstanding in each year.

Recent accounting pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, ("FIN 48,"), which clarifies the accounting and disclosures for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 also provides guidance on the de-recognition of uncertain tax positions, financial statement classification, accounting for interest and penalties, accounting for interim periods and adds new disclosure requirements. The adoption of FIN 48 did not have a material impact on the Company's financial statements or disclosures. As of December 26, 2006 and March 27, 2007 the Company did not recognize any assets or liabilities for unrecognized tax benefits relative to uncertain tax positions. Upon review of the Company's net operating loss carryforwards, management believes it is more likely than

not that the Company's tax positions taken will be sustained. Any interest or penalties resulting from examinations will be recognized as a component of the income tax provision. However, since there are no unrecognized tax benefits as a result of tax positions taken, there are no accrued interest and penalties.

In March 2006, the FASB Emerging Issues Task Force issued Issue 06-3 ("EITF 06-3"), *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. A tentative consensus was reached that a company should disclose its accounting policy (i.e., gross or net presentation) regarding presentation of taxes within the scope of EITF 06-3. If taxes are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. The guidance is effective for periods beginning after December 15, 2006. The Company presents sales tax on a net basis in its consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors on each financial statement and related financial statement disclosure using both the rollover approach and the iron curtain approach, as those terms are defined in SAB 108. The rollover approach quantifies misstatements based on the amount of the error in the current year financial statement, whereas the iron curtain approach quantifies misstatements based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origin. Financial statements would require adjustment when either approach results in quantifying a misstatement that is material. Correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. If a company determines that an adjustment to prior year financial statements is required upon adoption of SAB 108 and does not elect to restate its previous financial statements, then it must recognize the cumulative effect of applying SAB 108 in fiscal year 2006 beginning balances of the affected assets and liabilities with a corresponding adjustment to the fiscal year 2006 opening balance in retained earnings. SAB 108 is effective for interim periods of the first fiscal year ending after November 15, 2006. The adoption of SAB 108 did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 provides guidance for using fair value to measure assets and liabilities. The standard expands required disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities (as amended)* ("SFAS 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The standard provides companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The provisions of SFAS 159 are effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on its financial statements.

2. Non-current assets

Property and equipment

The cost of property and equipment is depreciated over the estimated useful lives of the related assets. The cost of leasehold improvements is depreciated over the initial term of the related lease. Depreciation is computed on the straight-line method for financial reporting purposes and accelerated methods for income tax purposes. Amortization of assets acquired under capital lease is included in depreciation expense. The following is a summary of the Company's property and equipment at March 27, 2007 and December 26, 2006:

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
Land	\$ 18,000	\$ 18,000
Buildings	33,851,945	33,851,945
Leasehold improvements	8,238,133	8,220,963
Equipment and furniture	20,967,997	20,728,013
Construction in progress*	424,796	624,422
	<u>63,500,871</u>	<u>63,443,343</u>
Less accumulated depreciation	10,519,777	9,425,219
	<u>\$ 52,981,094</u>	<u>\$ 54,018,124</u>

*Construction in progress includes the following approximate amounts for items yet to be placed in service:

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
Architecture fees for future locations	\$ 182,000	\$ 100,000
Equipment at future locations	\$ 222,000	\$ 400,000
Equipment at the beer production facility	—	\$ 125,000
Cost to secure property leases at future locations	\$ 21,000	—

Included in property and equipment are the following assets held under capital leases:

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
Land	\$ 18,000	\$ 18,000
Building	33,851,945	33,851,945
Equipment and leasehold improvements	1,624,533	7,807,724
	<u>35,494,478</u>	<u>41,677,669</u>
Less accumulated depreciation	3,887,230	3,718,654
	<u>\$ 31,607,248</u>	<u>\$ 37,959,015</u>

Intangible assets and other

Intangible assets and other assets consisted of the following:

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
Intangible assets:		
Liquor licenses	\$ 264,415	\$ 264,415
Trademarks	119,251	109,741
Other:		
Capitalized loan costs	175,379	205,054
Security deposits	272,279	279,427
	<u>831,324</u>	<u>858,637</u>
Less accumulated amortization	105,432	98,217
	<u>\$ 725,892</u>	<u>\$ 760,420</u>

3. Accrued expenses

Accrued expenses consisted of the following:

	<u>March 27, 2007</u>	<u>December 26, 2006</u>
Payroll related	\$ 1,450,032	\$ 2,205,712
Deferred revenue from gift cards	851,491	1,355,773
Sales taxes	472,316	493,772
Interest	248,078	278,131
Real estate taxes	314,988	245,299
Insurance	222,023	89,646
Other	347,059	436,397
	<u>\$ 3,905,987</u>	<u>\$ 5,104,730</u>

4. Capital leases

In March 2007, the Company completed a private placement of common stock to accredited investors described in Note 7 below. Utilizing approximately \$6.0 million of these proceeds, the Company retired the entire balance of capital lease debt due DHW Leasing, L.L.C. ("DHW") pursuant to the master lease agreement entered into in September 2006.

Minimum future lease payments under all capital leases as of March 27, 2007 are:

<u>Year ended:</u>	<u>Capital Leases</u>
2007	\$ 3,120,764
2008	4,075,768
2009	4,008,950
2010	3,839,235
2011	3,737,719
Thereafter	<u>52,462,327</u>
Total minimum lease payments	71,244,763
Less amount representing interest	<u>38,147,063</u>
Present value of net minimum lease payments	33,097,700
Less current portion	<u>933,420</u>
Long-term portion of obligations	<u>\$ 32,164,280</u>

Amortization expense related to the assets held under capital leases is included with depreciation expense on the Company's statements of operations.

5. Commitments and contingencies

Rockford, Illinois:

In January 2007, the Company entered into a 15-year net lease agreement relating to the restaurant it anticipates opening during 2007 in Rockford, Illinois, under the terms specified in the development agreement with Dunham Capital Management L.L.C. ("Dunham"). The restaurant will be constructed for the Company on a build-to-suit basis and the annual rent of will be equal to 10.5% of the construction cost including land cost and will escalate 10% at the end of each five-year period. The Company will be responsible for any real-estate taxes and all operating costs. The term of the lease will commence when operations begin and may be extended at the Company's option for up to three additional five-year periods on the same terms and conditions, except the rent may increase based on a formula using the Consumer Price Index during any such extension. Rental costs associated with the operating lease incurred during the construction period are recognized as pre-opening costs and escalated rent will be recognized as expense on a straight-line basis over the term of the lease.

East Peoria and Orland Park, Illinois:

In January and February 2007, the Company entered into 20-year net lease agreements relating to restaurants it anticipates opening during 2007 in East Peoria and Orland Park, Illinois, under the terms specified in the development agreement with Dunham. Each restaurant will be constructed for the Company on a build-to-suit