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

FORM 10-Q

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

For the quarter ended June 29, 2008

Commission file number 333-142081

SBARRO, INC.

(Exact name of registrant as specified in its charter)

NEW YORK

(State or other jurisdiction of incorporation or organization)

11-2501939

(I.R.S. Employer Identification No.)

401 Broad Hollow Road, Melville, New York

(Address of principal executive offices)

11747-4714

(Zip Code)

Registrant's telephone number, including area code: (631) 715-4100

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The number of shares of Common Stock of the registrant outstanding as of August 8, 2008 was 100.

SBARRO, INC.
FORM 10-Q INDEX

| <u>PART I. FINANCIAL INFORMATION</u> | PAGES |
|---|--------------|
| Item 1. <u>Consolidated Financial Statements (unaudited):</u> | |
| <u>Balance Sheets (unaudited)—June 29, 2008 (Successor) and December 30, 2007 (Successor)</u> | 3-4 |
| <u>Statements of Operations (unaudited)—Six months ended June 29, 2008 (Successor), the period January 31 through July 1, 2007 (Successor) and the period January 1 through January 30, 2007 (Predecessor) and the three months ended June 29, 2008 (Successor) and the three months ended July 1, 2007 (Successor)</u> | 5-6 |
| <u>Statements of Cash Flows (unaudited)—Six months ended June 29, 2008 (Successor), the period January 31 through July 1, 2007 (Successor) and the period January 1 through January 30, 2007 (Predecessor)</u> | 7-8 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 9 |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | 25 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 33 |
| Item 4T. <u>Controls and Procedures</u> | 34 |
| <u>PART II. OTHER INFORMATION</u> | |
| Item 1. <u>Legal Proceedings</u> | 35 |
| Item 1A. <u>Risk Factors</u> | 35 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 35 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 35 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 35 |
| Item 5. <u>Other Information</u> | 35 |
| Item 6. <u>Exhibits</u> | 36 |

Part I – Financial Information
Item 1. Consolidated Financial Statements

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
ASSETS
(Unaudited)
(In thousands)

| | <u>June 29, 2008</u> | <u>December 30, 2007</u> |
|---|----------------------|--------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 13,335 | \$ 28,867 |
| Receivables, net of allowance for doubtful accounts of \$55 at June 29, 2008: | | |
| Franchise | 3,528 | 2,938 |
| Other | 3,754 | 4,552 |
| | <u>7,282</u> | <u>7,490</u> |
| Inventories | 2,921 | 3,056 |
| Prepaid expenses | 5,226 | 3,480 |
| Deferred tax asset | 4,315 | 2,331 |
| Total current assets | <u>33,079</u> | <u>45,224</u> |
| Property and equipment, net | 67,870 | 65,343 |
| Intangible assets: | | |
| Goodwill | 211,437 | 211,236 |
| Trademarks | 248,000 | 248,000 |
| Other intangible assets | 31,268 | 31,996 |
| Deferred financing costs, net | 9,514 | 10,069 |
| Deferred tax asset | 27,278 | 23,850 |
| Other assets | 922 | 1,053 |
| Total assets | <u>\$ 629,368</u> | <u>\$ 636,771</u> |

See notes to unaudited consolidated financial statements.

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
LIABILITIES & SHAREHOLDERS' EQUITY (DEFICIT)
(Unaudited)
(In thousands except shareholders)
(CONTINUED)

| | <u>June 29, 2008</u> | <u>December 30, 2007</u> |
|--|----------------------|--------------------------|
| Current liabilities: | | |
| Accounts payable | \$ 12,427 | \$ 8,586 |
| Accrued expenses | 19,305 | 22,584 |
| Accrued interest payable | 7,372 | 7,745 |
| Due to former shareholders | 6,200 | 6,200 |
| Taxes payable on behalf of former shareholders | 572 | 2,072 |
| Insurance premium financing | 2,959 | 1,101 |
| Current portion of debt | 1,830 | 1,830 |
| Total current liabilities | <u>50,665</u> | <u>50,118</u> |
| Deferred rent | 4,322 | 3,587 |
| Deferred tax liability | 107,249 | 107,130 |
| Due to former shareholders & other liabilities | 9,895 | 10,052 |
| Long-term debt | 329,340 | 330,255 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock | | |
| Authorized 1,000 shares; \$.01 par value issued and outstanding 100 shares at June 29, 2008 and December 30, 2007 | — | — |
| Additional paid-in capital | 133,000 | 133,000 |
| (Accumulated deficit) retained earnings | <u>(5,103)</u> | <u>2,629</u> |
| Total shareholders' equity | <u>127,897</u> | <u>135,629</u> |
| Total liabilities and shareholders' equity | <u>\$ 629,368</u> | <u>\$ 636,771</u> |

See notes to unaudited consolidated financial statements.

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands)

| | For the six months ended June 29, 2008 <u>SUCCESSOR</u> | For the period January 31 through July 1, 2007 <u>SUCCESSOR</u> | For the period January 1 through January 30, 2007 <u>PREDECESSOR</u> |
|--|--|--|---|
| Revenues: | | | |
| Restaurant sales | \$ 160,896 | \$ 132,051 | \$ 23,594 |
| Franchise related income | 7,724 | 6,119 | 993 |
| Real estate | — | — | 323 |
| Total revenues | <u>168,620</u> | <u>138,170</u> | <u>24,910</u> |
| Costs and expenses: | | | |
| Cost of food and paper products | 36,768 | 26,613 | 4,308 |
| Payroll and other employee benefits | 46,728 | 37,091 | 6,762 |
| Other operating costs | 61,200 | 48,604 | 8,839 |
| Other income, net | (1,901) | (1,131) | (497) |
| Depreciation and amortization | 8,734 | 7,538 | 1,272 |
| General and administrative | 14,245 | 11,261 | 2,843 |
| Special event bonuses | — | — | 31,395 |
| Asset impairment, restaurant closings/remodels | 335 | 209 | 74 |
| Total costs and expenses, net | <u>166,109</u> | <u>130,185</u> | <u>54,996</u> |
| Operating income (loss) | <u>2,511</u> | <u>7,985</u> | <u>(30,086)</u> |
| Other (expense) income: | | | |
| Interest expense | (15,045) | (13,363) | (2,570) |
| Interest income | 107 | 404 | 108 |
| Equity in net (loss) income of unconsolidated affiliates | (128) | — | 12 |
| Net other expense | <u>(15,066)</u> | <u>(12,959)</u> | <u>(2,450)</u> |
| Loss before income taxes | <u>(12,555)</u> | <u>(4,974)</u> | <u>(32,536)</u> |
| Income tax (benefit) expense | (4,823) | (1,982) | 44 |
| Net loss | <u>\$ (7,732)</u> | <u>\$ (2,992)</u> | <u>\$ (32,580)</u> |

See notes to unaudited consolidated financial statements.

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands)

| | For the quarter ended June 29, 2008 SUCCESSOR | For the quarter ended July 1, 2007 SUCCESSOR |
|---|---|--|
| Revenues: | | |
| Restaurant sales | \$ 81,143 | \$ 78,959 |
| Franchise related income | 4,239 | 3,642 |
| Total revenues | <u>85,382</u> | <u>82,601</u> |
| Costs and expenses: | | |
| Cost of food and paper products | 19,386 | 15,916 |
| Payroll and other employee benefits | 24,415 | 22,118 |
| Other operating costs | 31,191 | 29,605 |
| Other income, net | (682) | (706) |
| Depreciation and amortization | 4,616 | 4,622 |
| General and administrative | 7,010 | 6,838 |
| Asset impairment, restaurant closings/remodels | 168 | 126 |
| Total costs and expenses | <u>86,104</u> | <u>78,519</u> |
| Operating (loss) income | <u>(722)</u> | <u>4,082</u> |
| Other (expense) income: | | |
| Interest expense | (7,309) | (8,059) |
| Interest income | 34 | 72 |
| Equity in net income of unconsolidated affiliates | 22 | — |
| Net other expense | <u>(7,253)</u> | <u>(7,987)</u> |
| Income before income taxes | <u>(7,975)</u> | <u>(3,905)</u> |
| Income tax benefit | <u>(2,994)</u> | <u>(1,542)</u> |
| Net loss | <u>\$ (4,981)</u> | <u>\$ (2,363)</u> |

See notes to unaudited consolidated financial statements.

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | For the six months ended <u>June 29, 2008</u> SUCCESSOR | For the period January 31 through <u>July 1, 2007</u> SUCCESSOR | For the period January 1 through <u>January 30, 2007</u> PREDECESSOR |
|--|--|--|---|
| Operating Activities: | | | |
| Net loss | \$ (7,732) | \$ (2,992) | \$ (32,580) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | | |
| Depreciation and amortization | 8,734 | 7,538 | 1,272 |
| Amortization of deferred financing costs | 554 | 604 | 112 |
| Increase (decrease) in deferred rent, net of tenant allowance | 778 | 626 | (117) |
| Asset impairment and restaurant closings/remodels | 335 | 208 | 74 |
| Deferred tax benefit | (5,292) | (2,543) | — |
| Equity in net loss (income) of unconsolidated affiliates | 128 | — | (12) |
| Changes in operating assets and liabilities, net of effects of merger: | | | |
| (Increase) decrease in receivables | (203) | 1,913 | 394 |
| Decrease (increase) in inventories | 267 | (6) | 319 |
| Decrease (increase) in prepaid expenses | 379 | 1,507 | (1,434) |
| Decrease (increase) in other assets | 112 | (641) | 871 |
| (Decrease) increase in accounts payable, accrued expenses & other liabilities | (2,012) | 878 | 23,474 |
| (Decrease) increase in accrued interest payable | (374) | 7,817 | 2,337 |
| Net cash (used in) provided by operating activities | <u>(4,326)</u> | <u>14,909</u> | <u>(5,290)</u> |

(Continued)

SBARRO, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)
(CONTINUED)

| | For the six months ended June 29, 2008 SUCCESSOR | For the period January 31 through July 1, 2007 SUCCESSOR | For the period January 1 through January 30, 2007 PREDECESSOR |
|---|---|---|--|
| Investing Activities: | | | |
| Purchases of property and equipment | (9,548) | (6,299) | (1,691) |
| Purchases of franchises and other locations | (619) | (4,790) | — |
| Investment in joint ventures | (124) | — | — |
| Cash paid for merger, net of cash acquired | — | (188,000) | — |
| Net cash used in investing activities | <u>(10,291)</u> | <u>(199,089)</u> | <u>(1,691)</u> |
| Financing Activities: | | | |
| Proceeds from shareholders for issuance of common stock | — | 133,000 | — |
| Proceeds from secured term loan | — | 183,000 | — |
| Proceeds from senior notes | — | 150,000 | — |
| Paydown of Predecessor's notes | — | (267,000) | — |
| Repayment of secured term loan | (915) | (458) | — |
| Mortgage principal repayments | — | — | (17) |
| Dividends to sellers | — | — | (76,159) |
| Repayment of loans by officers | — | — | 5,530 |
| Net cash (used in) provided by financing activities | <u>(915)</u> | <u>198,542</u> | <u>(70,646)</u> |
| (Decrease) increase in cash and cash equivalents | <u>(15,532)</u> | <u>14,362</u> | <u>(77,627)</u> |
| Cash and cash equivalents at beginning of period | 28,867 | — | 88,627 |
| Cash and cash equivalents at end of period | <u>\$ 13,335</u> | <u>\$ 14,362</u> | <u>\$ 11,000</u> |

Supplemental non-cash investing activities:

On January 30, 2007, the Company transferred its interest of \$5.6 million of certain non-core assets to a newly-formed company owned by certain of our former shareholders as a dividend.

Supplemental non-cash financing activities:

The Company entered into a non-cash insurance premium financing agreement for \$3.0 million and \$3.5 million in June 2008 and June 2007, respectively.

See notes to unaudited consolidated financial statements.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements

1. Basis of financial statement presentation:

On January 31, 2007, entities controlled by MidOcean Partners III, LP, a private equity firm, and certain of its affiliates (“MidOcean”) acquired the Company, pursuant to an agreement and plan of merger (“Merger Agreement”). MidOcean SBR Acquisition Corp., a wholly-owned subsidiary of Sbarro Holdings, LLC, merged with and into the Company (the “Merger”), with the Company surviving the Merger. Sbarro Holdings, LLC is a wholly-owned subsidiary of MidOcean SBR Holdings, LLC (“Holdings”). Sbarro Holdings, LLC owns 100% of our outstanding common stock and Holdings owns 100% of the limited liability company interests of Sbarro Holdings, LLC.

MidOcean owns approximately 74% of Holdings and thus acquired control of the Company in the Merger. Certain of our senior managers acquired approximately 5% of the outstanding equity of Holdings in connection with the Merger, with the balance of the equity of Holdings being owned by other investors.

As a result of the Merger, we are required to present our results for the first six months of 2007 as two separate periods. Our Predecessor financial period refers to the period from January 1 through January 30, 2007 prior to consummation of the Merger. Our Successor financial period refers to the period from January 31 through July 1, 2007 following consummation of the Merger.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and Regulation S-X related to interim period financial statements and, therefore, do not include all information and footnotes required by generally accepted accounting principles. However, in the opinion of our management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation of the consolidated financial position of Sbarro and our subsidiaries at June 29, 2008 (Successor) and our consolidated results of operations for the three months ended June 29, 2008 (Successor) and the three months ended July 1, 2007 (Successor) and our consolidated results of operations and cash flows for the six months ended June 29, 2008 (Successor) and the period January 31, 2007 through July 1, 2007 (Successor) and the period January 1, 2007 through January 30, 2007 (Predecessor) have been included. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the entire year. Reference should be made to our annual financial statements, including footnotes thereto, included in our Annual Report on Form 10-K for the year ended December 30, 2007.

Certain reclassifications have been made to the prior year’s financial statements to conform to the current presentation.

2. Recent Accounting Pronouncements:

SFAS 157:

In September 2006, FASB issued Statement SFAS No. 157, “Fair Value Measurements” (“SFAS No. 157”). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. This statement does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued FSP 157-2 to allow a one-year deferral of adoption of SFAS No. 157 for non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The FASB issued FSP 157-1 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions. We elected to defer adoption of SFAS No. 157 for non-financial assets and non-financial liabilities and we do not currently anticipate that full adoption in 2009 will materially impact our consolidated financial statements. We evaluated SFAS No. 157 and determined that the adoption of the provisions effective December 31, 2007 did not have a material effect on our consolidated financial statements.

SFAS 159:

In September 2006, the FASB issued Statement SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (“SFAS No. 159”), which is effective for fiscal years beginning after November 15, 2007. Under SFAS No. 159, a company may elect to measure eligible financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. We evaluated SFAS No. 159 and do not have any items eligible for the fair value accounting option; therefore, SFAS No. 159 had no impact on our consolidated financial statements.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Continued)

SFAS 141 (R):

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“FAS 141(R)”), which is effective for annual periods beginning on or after December 15, 2008. In FAS 141(R), the FASB retained the fundamental requirements of Statement No. 141 to account for all business combinations using the acquisition method (formerly the purchase method) and for an acquiring entity to be identified in all business combinations. However, the new standard requires the acquiring entity in a business combination to recognize the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date for value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. The Company will apply the provisions of this statement prospectively to business combinations for which the acquisition date is on or after December 29, 2008 and is currently assessing the impact of adoption of SFAS No. 141(R) on its consolidated financial statements.

SFAS 160:

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment to ARB No. 51” (“SFAS No. 160”) which is effective for fiscal years beginning on or after December 15, 2008. SFAS No. 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements, but separate from the equity of the parent company. The statement further requires that consolidated net income be reported at amounts attributable to the parent and the noncontrolling interest, rather than expensing the income attributable to the minority interest holder. This statement also requires that companies provide sufficient disclosures to clearly identify and distinguish between the interest of the parent company and the interest of the noncontrolling interest holder. We have not yet determined the impact that SFAS No. 160 will have on our consolidated financial statements.

FSP 142-3

In April 2008, the FASB issued FASB Staff Position No. FSP 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP No. 142-3”). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets”. The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other U.S. generally accepted accounting principles. FSP 142-3 is effective for the Company in the first quarter of 2009 and will be applied prospectively to future business combinations.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Continued)

3. Long Term Debt:

Indenture:

In connection with the Merger, we issued \$150.0 million of senior notes at 10.375% due 2015 (“Senior Notes”). The interest is payable on February 1 and August 1 of each year.

The Senior Notes are senior unsecured obligations of ours and are guaranteed by all of our current and future domestic subsidiaries and rank equally in right of payment with all existing and future senior indebtedness of ours. The Senior Notes are effectively subordinated to all secured indebtedness of ours to the extent of the collateral securing such indebtedness, including the Senior Credit Facilities. In the event of any distribution or payment of our assets in any foreclosure, dissolution, winding-up, liquidation, reorganization, or other bankruptcy proceeding, holders of secured indebtedness will have prior claim to those of our assets that constitute their collateral. The Senior Notes are structurally subordinated to all existing and future indebtedness, claims of holders of preferred stock and other liabilities of our subsidiaries that do not guarantee the Senior Notes. In the event of a bankruptcy, liquidation or reorganization of any of our non-guarantor subsidiaries, holders of their indebtedness and their trade creditors will generally be entitled to payment of their claims in full from the assets of those subsidiaries before any assets are made available for distribution to us. The Senior Notes are senior in right of payment to any future subordinated obligations of ours.

The indenture governing the notes contains certain events of default and restrictive covenants which are customary with respect to non-investment grade debt securities, including limitations on the incurrence of additional indebtedness, dividends, repurchases of capital stock, sales of assets, liens, mergers and transactions with affiliates.

Senior Credit Facilities:

In connection with the Merger, we entered into senior secured credit facilities. The senior secured credit facilities provide for loans of \$208.0 million under a \$183.0 million senior secured term loan facility and a \$25.0 million senior secured revolving facility (the “Senior Credit Facilities”). The revolving facility also provides for the issuance of letters of credit not to exceed \$10.0 million at any one time outstanding and swing line loans not to exceed \$5.0 million at any one time outstanding. In addition, the Senior Credit Facilities provide for an uncommitted incremental facility of up to \$50.0 million. In connection with the Merger, we borrowed the entire \$183.0 million available under the term loan facility. The term loan facility (the “Term Loan”) will mature in 2014 and the revolving credit facility is scheduled to terminate and come due in 2013.

In general, borrowings under the Senior Credit Facilities bear interest based, at our option, at either the Eurodollar rate or an alternate base rate (“ABR”), in each case plus a margin. The applicable margin will be based on our total leverage ratio (as defined in the credit agreement governing the Senior Credit Facilities) at the time of determination. Our rate of interest for borrowings under the Senior Credit Facilities is LIBOR plus 2.50% or ABR plus 1.50%. In addition to paying interest on outstanding principal under the Senior Credit Facilities, we are required to pay an unused line fee to the lenders with respect to the unutilized revolving commitments at a rate that shall not exceed 50 basis points per annum.

Our obligations under the Senior Credit Facilities are unconditionally and irrevocably guaranteed by our domestic subsidiaries. In addition, the Senior Credit Facilities are secured by first priority perfected security interests in substantially all of our and our domestic subsidiaries’ capital stock, and up to 65% of the outstanding capital stock of our foreign subsidiaries.

The credit agreement governing the Senior Credit Facilities contains certain events of default and restrictive covenants which are customary with respect to facilities of this type, including limitations on the incurrence of additional indebtedness, dividends, investments, repayment of certain indebtedness, sales of assets, liens, mergers and transactions with affiliates. In addition, the credit agreement requires compliance with certain financial and operating covenants, including a minimum cash interest coverage ratio and a maximum net leverage ratio.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Continued)

Long-Term Debt matures as follows (In millions):

| | |
|---------------------|---------|
| Year ending 2008 | \$.9 |
| 2009 | 1.8 |
| 2010 | 1.8 |
| 2011 | 1.8 |
| 2012 | 1.8 |
| 2013 and thereafter | \$323.1 |

Line and Letters of Credit:

In connection with the Merger, we obtained a line of credit facility of \$25.0 million, with a sub-limit for letters of credit of \$10.0 million. This replaced our prior line of credit. There were \$3.7 million of letters of credit outstanding as of June 29, 2008. The letters of credit have been issued instead of cash security deposits under our operating leases or to guarantee construction costs of our locations, and for run-out claims under our medical plan.

4. Income Taxes:

Effective January 31, 2007, the Company has been organized as a C Corporation. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We have not provided a valuation allowance for the deferred income tax asset since we believe it is more likely than not that the Company's earnings will be sufficient to ensure the realization of the deferred income tax assets for federal and state purposes.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Continued)

5. Business Segment Information:

We operate our business through two segments. Our company-owned restaurant segment is comprised of the operating activities of our company-owned QSR's and other concept restaurants. Our franchise restaurant segment is comprised of our franchised restaurants which offer opportunities worldwide for qualified operators to conduct business under the Sbarro name and other trade names owned by Sbarro. Revenue from our franchised restaurant segment is generated from initial franchise fees, ongoing royalties and other franchising revenue. We do not allocate indirect corporate charges to our operating segments. Such costs are managed on an entity-wide basis, and the information to reasonably allocate such costs is not readily available. We do not allocate assets by segment because our chief operating decision makers do not review the assets by segment to assess performance, as the assets are managed on an entity-wide basis. Our operating segments are discussed in *Note 3—Summary of Significant Accounting Policies* and *Note 15—Business Segment Information* to our *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 30, 2007.

The following table sets forth the information concerning the revenue and operating income before unallocated costs of each of our company-owned and franchised restaurant segments:

| | Company- Owned Restaurants(1) | Franchised Restaurants (In thousands) | Totals |
|--|-------------------------------------|---|-------------|
| 2nd Quarter 2008 (Successor) | | | |
| Total revenue | \$ 81,143 | \$ 4,239 | \$ 85,382 |
| Operating income before unallocated costs | 2,052 | 3,158 | 5,210 |
| Unallocated costs and expenses ⁽²⁾ | | | 5,932 |
| Operating loss | | | \$ (722) |
| 2nd Quarter 2007 (Successor) | | | |
| Total revenue | \$ 78,959 | \$ 3,642 | \$ 82,601 |
| Operating income before unallocated costs | 7,279 | 2,525 | 9,804 |
| Unallocated costs and expenses ⁽²⁾ | | | 5,722 |
| Operating income | | | \$ 4,082 |
| YTD 2nd Quarter 2008 (Successor) | | | |
| Total revenue | \$ 160,896 | \$ 7,724 | \$168,620 |
| Operating income before unallocated costs | 9,035 | 5,340 | 14,375 |
| Unallocated costs and expenses ⁽²⁾ | | | 11,864 |
| Operating income | | | \$ 2,511 |
| YTD 2nd Quarter 2007 (Combined) ⁽⁴⁾ | | | |
| Total revenue | \$ 155,968 | \$ 7,112 | \$163,080 |
| Operating income before unallocated costs | 16,290 | 4,625 | 20,915 |
| Unallocated costs and expenses ⁽²⁾ | | | 43,016 |
| Operating loss ⁽³⁾ | | | \$ (22,101) |
| 1/31/07—7/1/07 (Successor) | | | |
| Total revenue | \$ 132,051 | \$ 6,119 | \$138,170 |
| Operating income before unallocated costs | 13,130 | 4,031 | 17,161 |
| Unallocated costs and expenses ⁽²⁾ | | | 9,176 |
| Operating income | | | \$ 7,985 |
| 1/1/07—1/30/07 (Predecessor) | | | |
| Total revenue | \$ 23,917 | \$ 993 | \$ 24,910 |
| Operating income before unallocated costs | 3,160 | 594 | 3,754 |
| Unallocated costs and expenses ⁽²⁾ | | | 33,840 |
| Operating loss ⁽³⁾ | | | \$ (30,086) |

- (1) Total revenue includes restaurant sales in the Successor period and restaurant sales and real estate revenues in the Predecessor period.
- (2) Represents those general and administrative expenses that are not allocated to a segment.
- (3) 2007 includes \$31.4 million related to a special event bonus.
- (4) The combined results of the Successor and Predecessor for the periods in 2007 do not comply with generally accepted accounting principles; however, we believe these results provide useful information to assess the relative performance of the businesses in all periods presented in the financial statements on an ongoing basis.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Continued)

6. Guarantor and non-guarantor financial statements:

Certain subsidiaries have guaranteed amounts outstanding under our credit facilities. Each of the guaranteeing subsidiaries is a direct or indirect wholly-owned subsidiary of the Company and each has fully and unconditionally guaranteed the Senior Notes and the Senior Credit Facilities on a joint and several basis.

The following condensed consolidating financial information presents:

- (1) Condensed unaudited consolidating balance sheets as of June 29, 2008 and December 30, 2007 and unaudited statements of operations for the three months ended June 29, 2008 and the three months ended July 1, 2007 and our unaudited statement of operations and cash flows for the six months ended June 29, 2008 and the period January 31 through July 1, 2007: (a) Sbarro, (“the Parent”), (b) the guarantor subsidiaries as a group, (c) the nonguarantor subsidiaries as a group, and (d) Sbarro on a consolidated basis.
- (2) Elimination entries necessary to consolidate the Parent with the guarantor and nonguarantor subsidiaries.

The principal elimination entries eliminate intercompany balances and transactions. Investments in subsidiaries are accounted for by the Parent on the cost method.

SBARRO INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
Consolidating Balance Sheet—Successor
As of June 29, 2008
ASSETS
(In thousands)
(Continued)

| | <u>Parent</u> | <u>Guarantor Subsidiaries</u> | <u>Nonguarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated Total</u> |
|-------------------------------|------------------|-----------------------------------|--------------------------------------|---------------------|-------------------------------|
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 11,228 | \$ 1,823 | \$ 284 | \$ — | \$ 13,335 |
| Receivables | | | | | |
| Franchise | 3,528 | — | — | — | 3,528 |
| Other | 2,774 | 836 | 401 | (257) | 3,754 |
| | 6,302 | 836 | 401 | (257) | 7,282 |
| Inventories | 1,181 | 1,595 | 145 | — | 2,921 |
| Prepaid expenses | 4,518 | 444 | 264 | — | 5,226 |
| Deferred tax asset | 4,315 | — | — | — | 4,315 |
| Total current assets | 27,544 | 4,698 | 1,094 | (257) | 33,079 |
| Intercompany receivables | (26,825) | 28,026 | (1,475) | 274 | — |
| Investment in subsidiaries | 66,049 | — | 274 | (66,323) | — |
| Property and equipment, net | 25,576 | 41,506 | 1,018 | (230) | 67,870 |
| Goodwill | 211,437 | — | — | — | 211,437 |
| Trademarks | 248,000 | — | — | — | 248,000 |
| Other intangible assets | 31,268 | — | — | — | 31,268 |
| Deferred financing costs, net | 9,514 | — | — | — | 9,514 |
| Deferred tax asset | 27,278 | — | — | — | 27,278 |
| Other assets | 889 | 161 | — | (128) | 922 |
| Total assets | <u>\$620,730</u> | <u>\$ 74,391</u> | <u>\$ 911</u> | <u>\$ (66,664)</u> | <u>\$ 629,368</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Balance Sheet—Successor
As of June 29, 2008
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)
(In thousands)
(Continued)

| | <u>Parent</u> | <u>Guarantor Subsidiaries</u> | <u>Nonguarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated Total</u> |
|--|-------------------------|-----------------------------------|--------------------------------------|---------------------------|-------------------------------|
| Current liabilities: | | | | | |
| Accounts payable | \$ 11,912 | \$ 251 | \$ 264 | \$ — | \$ 12,427 |
| Accrued expenses | 16,668 | 1,944 | 1,308 | (615) | 19,305 |
| Accrued interest payable | 7,372 | — | — | — | 7,372 |
| Due to former shareholders | 6,200 | — | — | — | 6,200 |
| Taxes payable on behalf of former shareholders | 572 | — | — | — | 572 |
| Insurance premium financing | 2,959 | — | — | — | 2,959 |
| Current portion of debt | 1,830 | — | — | — | 1,830 |
| Total current liabilities | <u>47,513</u> | <u>2,195</u> | <u>1,572</u> | <u>(615)</u> | <u>50,665</u> |
| Deferred rent | 655 | 3,667 | — | — | 4,322 |
| Deferred tax liability | 107,249 | — | — | — | 107,249 |
| Due to former shareholders & other liabilities | 8,076 | 1,819 | — | — | 9,895 |
| Long-term debt | 329,340 | — | — | — | 329,340 |
| Shareholders' equity: | | | | | |
| Common stock, \$.01 par value, 1000 shares authorized, 100 issued & outstanding | — | — | — | — | — |
| Additional paid-in capital | 133,000 | 68,302 | — | (68,302) | 133,000 |
| (Accumulated deficit) retained earnings | (5,103) | (1,592) | (661) | 2,253 | (5,103) |
| | <u>127,897</u> | <u>66,710</u> | <u>(661)</u> | <u>(66,049)</u> | <u>127,897</u> |
| Total liabilities and shareholders' equity | <u><u>\$620,730</u></u> | <u><u>\$ 74,391</u></u> | <u><u>\$ 911</u></u> | <u><u>\$ (66,664)</u></u> | <u><u>\$ 629,368</u></u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Balance Sheet—Successor
As of December 30, 2007

ASSETS
(In thousands)
(Continued)

| | <u>Parent</u> | <u>Guarantor Subsidiaries</u> | <u>Nonguarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated Total</u> |
|-------------------------------|------------------|-----------------------------------|--------------------------------------|---------------------|-------------------------------|
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 25,693 | \$ 2,893 | \$ 281 | \$ — | \$ 28,867 |
| Receivables | | | | | |
| Franchise | 2,938 | — | — | — | 2,938 |
| Other | 3,484 | 1,001 | 67 | — | 4,552 |
| | 6,422 | 1,001 | 67 | — | 7,490 |
| Inventories | 1,310 | 1,731 | 15 | — | 3,056 |
| Prepaid expenses | 3,070 | 410 | — | — | 3,480 |
| Deferred tax asset | 2,331 | — | — | — | 2,331 |
| Total current assets | 38,826 | 6,035 | 363 | — | 45,224 |
| Intercompany receivables | (34,460) | 35,043 | (583) | — | — |
| Investment in subsidiaries | 71,588 | — | — | (71,588) | — |
| Property and equipment, net | 28,420 | 36,908 | 15 | — | 65,343 |
| Goodwill | 211,236 | — | — | — | 211,236 |
| Trademarks | 248,000 | — | — | — | 248,000 |
| Other intangible assets | 31,996 | — | — | — | 31,996 |
| Deferred financing costs, net | 10,069 | — | — | — | 10,069 |
| Deferred tax asset | 23,850 | — | — | — | 23,850 |
| Other assets | 959 | 94 | — | — | 1,053 |
| Total assets | <u>\$630,484</u> | <u>\$ 78,080</u> | <u>\$ (205)</u> | <u>\$ (71,588)</u> | <u>\$ 636,771</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Balance Sheet—Successor
As of December 30, 2007
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)
(In thousands)
(Continued)

| | <u>Parent</u> | <u>Guarantor Subsidiaries</u> | <u>Nonguarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated Total</u> |
|--|-------------------------|-----------------------------------|--------------------------------------|---------------------------|-------------------------------|
| Current liabilities: | | | | | |
| Accounts payable | \$ 8,345 | \$ 191 | \$ 50 | \$ — | \$ 8,586 |
| Accrued expenses | 21,157 | 1,466 | (39) | — | 22,584 |
| Accrued interest payable | 7,745 | — | — | — | 7,745 |
| Due to former shareholders | 6,200 | — | — | — | 6,200 |
| Taxes payable on behalf of former shareholders | 2,072 | — | — | — | 2,072 |
| Insurance premium financing | 1,101 | — | — | — | 1,101 |
| Current portion of debt | 1,830 | — | — | — | 1,830 |
| Total current liabilities | <u>48,450</u> | <u>1,657</u> | <u>11</u> | <u>—</u> | <u>50,118</u> |
| Deferred rent | 919 | 2,668 | — | — | 3,587 |
| Deferred tax liability | 107,130 | — | — | — | 107,130 |
| Due to former shareholders & other liabilities | 8,101 | 1,951 | — | — | 10,052 |
| Long-term debt | 330,255 | — | — | — | 330,255 |
| Shareholders' equity: | | | | | |
| Common stock, \$.01 par value, 1000 shares authorized, 100 issued & outstanding | — | — | — | — | — |
| Additional paid-in capital | 133,000 | 68,302 | — | (68,302) | 133,000 |
| Retained earnings (accumulated deficit) | 2,629 | 3,502 | (216) | (3,286) | 2,629 |
| | <u>135,629</u> | <u>71,804</u> | <u>(216)</u> | <u>(71,588)</u> | <u>135,629</u> |
| Total liabilities and shareholders' equity | <u><u>\$630,484</u></u> | <u><u>\$ 78,080</u></u> | <u><u>\$ (205)</u></u> | <u><u>\$ (71,588)</u></u> | <u><u>\$ 636,771</u></u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Operations—Successor
For the six months ended June 29, 2008
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|---|-------------------|---------------------------|------------------------------|-----------------|-----------------------|
| Revenues: | | | | | |
| Restaurant sales | \$ 68,893 | \$ 90,919 | \$ 1,084 | \$ — | \$ 160,896 |
| Franchise related income | 7,724 | — | — | — | 7,724 |
| Intercompany charges | 11,717 | (11,629) | (88) | — | — |
| Total revenues | <u>88,334</u> | <u>79,290</u> | <u>996</u> | <u>—</u> | <u>168,620</u> |
| Costs and expenses: | | | | | |
| Cost of food and paper products | 17,275 | 19,118 | 375 | — | 36,768 |
| Payroll and other employee benefits | 19,107 | 27,236 | 385 | — | 46,728 |
| Other operating costs | 26,078 | 34,640 | 482 | — | 61,200 |
| Other income, net | (563) | (1,294) | (44) | — | (1,901) |
| Depreciation and amortization | 4,295 | 4,349 | 90 | — | 8,734 |
| General and administrative | 14,245 | — | — | — | 14,245 |
| Asset impairment, restaurant closings | — | 335 | — | — | 335 |
| Total costs and expenses, net | <u>80,437</u> | <u>84,384</u> | <u>1,288</u> | <u>—</u> | <u>166,109</u> |
| Operating income (loss) | 7,897 | (5,094) | (292) | — | 2,511 |
| Other (expense) income: | | | | | |
| Interest expense | (15,018) | (1) | (26) | — | (15,045) |
| Interest income | 105 | 2 | — | — | 107 |
| Equity in net loss of unconsolidated affiliates | — | — | (128) | — | (128) |
| Net other (expense) income | <u>(14,913)</u> | <u>1</u> | <u>(154)</u> | <u>—</u> | <u>(15,066)</u> |
| Equity in loss of subsidiaries | (5,539) | — | — | 5,539 | — |
| Loss before income taxes | (12,555) | (5,093) | (446) | 5,539 | (12,555) |
| Income tax benefit | (4,823) | — | — | — | (4,823) |
| Net loss | <u>\$ (7,732)</u> | <u>\$ (5,093)</u> | <u>\$ (446)</u> | <u>\$ 5,539</u> | <u>\$ (7,732)</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Operations—Successor
For the period January 31—July 1, 2007
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|---------------------------------------|-------------------|---------------------------|------------------------------|-----------------|-----------------------|
| Revenues: | | | | | |
| Restaurant sales | \$ 58,350 | \$ 73,174 | \$ 527 | \$ — | \$ 132,051 |
| Franchise related income | 6,119 | — | — | — | 6,119 |
| Intercompany charges | 9,897 | (9,833) | (64) | — | — |
| Total revenues | <u>74,366</u> | <u>63,341</u> | <u>463</u> | <u>—</u> | <u>138,170</u> |
| Costs and expenses: | | | | | |
| Cost of food and paper products | 12,881 | 13,590 | 142 | — | 26,613 |
| Payroll and other employee benefits | 15,614 | 21,338 | 139 | — | 37,091 |
| Other operating costs | 21,426 | 26,981 | 197 | — | 48,604 |
| Depreciation and amortization | 3,941 | 3,596 | 1 | — | 7,538 |
| Other income, net | (38) | (1,077) | (16) | — | (1,131) |
| General and administrative | 11,047 | 34 | 180 | — | 11,261 |
| Asset impairment, restaurant closings | — | 209 | — | — | 209 |
| Total costs and expenses, net | <u>64,871</u> | <u>64,671</u> | <u>643</u> | <u>—</u> | <u>130,185</u> |
| Operating income (loss) | 9,495 | (1,330) | (180) | — | 7,985 |
| Other (expense) income: | | | | | |
| Interest expense | (13,363) | — | — | — | (13,363) |
| Interest income | 392 | 12 | — | — | 404 |
| Net other (expense) income | <u>(12,971)</u> | <u>12</u> | <u>—</u> | <u>—</u> | <u>(12,959)</u> |
| Equity in income of subsidiaries | (1,498) | — | — | 1,498 | — |
| (Loss) income before income taxes | (4,974) | (1,318) | (180) | 1,498 | (4,974) |
| Income tax benefit | (1,982) | — | — | — | (1,982) |
| Net (loss) income | <u>\$ (2,992)</u> | <u>\$ (1,318)</u> | <u>\$ (180)</u> | <u>\$ 1,498</u> | <u>\$ (2,992)</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Operations—Successor
For the three months ended June 29, 2008
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|---|-------------------|---------------------------|------------------------------|-----------------|-----------------------|
| Revenues: | | | | | |
| Restaurant sales | \$35,049 | \$ 45,350 | \$ 744 | \$ — | \$ 81,143 |
| Franchise related income | 4,239 | — | — | — | 4,239 |
| Intercompany charges | 5,783 | (5,738) | (45) | — | — |
| Total revenues | <u>45,071</u> | <u>39,612</u> | <u>699</u> | <u>—</u> | <u>85,382</u> |
| Costs and expenses: | | | | | |
| Cost of food and paper products | 9,004 | 10,093 | 289 | — | 19,386 |
| Payroll and other employee benefits | 9,955 | 14,161 | 299 | — | 24,415 |
| Other operating costs | 13,015 | 17,845 | 331 | — | 31,191 |
| Other income, net | (20) | (618) | (44) | — | (682) |
| Depreciation and amortization | 2,157 | 2,370 | 89 | — | 4,616 |
| General and administrative | 7,010 | — | — | — | 7,010 |
| Asset impairment, restaurant closings | — | 168 | — | — | 168 |
| Total costs and expenses, net | <u>41,121</u> | <u>44,019</u> | <u>964</u> | <u>—</u> | <u>86,104</u> |
| Operating income (loss) | 3,950 | (4,407) | (265) | — | (722) |
| Other (expense) income: | | | | | |
| Interest expense | (7,283) | — | (26) | — | (7,309) |
| Interest income | 34 | — | — | — | 34 |
| Equity in net loss of unconsolidated affiliates | 150 | — | (128) | — | 22 |
| Net other (expense) income | <u>(7,099)</u> | <u>—</u> | <u>(154)</u> | <u>—</u> | <u>(7,253)</u> |
| Equity in loss of subsidiaries | (4,826) | — | — | 4,826 | — |
| Loss before income taxes | (7,975) | (4,407) | (419) | 4,826 | (7,975) |
| Income tax benefit | (2,994) | — | — | — | (2,994) |
| Net (loss) income | <u>\$ (4,981)</u> | <u>\$ (4,407)</u> | <u>\$ (419)</u> | <u>\$ 4,826</u> | <u>\$ (4,981)</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Operations—Successor
For the three months ended July 1, 2007
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|---------------------------------------|-------------------|---------------------------|------------------------------|-----------------|-----------------------|
| Revenues: | | | | | |
| Restaurant sales | \$34,940 | \$ 43,687 | \$ 332 | \$ — | \$ 78,959 |
| Franchise related income | 3,642 | — | — | — | 3,642 |
| Intercompany charges | 8,127 | (8,073) | (54) | — | — |
| Total revenues | <u>46,709</u> | <u>35,614</u> | <u>278</u> | <u>—</u> | <u>82,601</u> |
| Costs and expenses: | | | | | |
| Cost of food and paper products | 7,820 | 8,006 | 90 | — | 15,916 |
| Payroll and other employee benefits | 9,387 | 12,645 | 86 | — | 22,118 |
| Other operating costs | 12,855 | 16,625 | 125 | — | 29,605 |
| Depreciation and amortization | 2,534 | 2,088 | — | — | 4,622 |
| Other income, net | 347 | (1,054) | 1 | — | (706) |
| General and administrative | 6,737 | 22 | 79 | — | 6,838 |
| Asset impairment, restaurant closings | — | 126 | — | — | 126 |
| Total costs and expenses, net | <u>39,680</u> | <u>38,458</u> | <u>381</u> | <u>—</u> | <u>78,519</u> |
| Operating income (loss) | 7,029 | (2,844) | (103) | — | 4,082 |
| Other (expense) income: | | | | | |
| Interest expense | (8,059) | — | — | — | (8,059) |
| Interest income | 70 | 2 | — | — | 72 |
| Net other (expense) income | <u>(7,989)</u> | <u>2</u> | <u>—</u> | <u>—</u> | <u>(7,987)</u> |
| Equity in income of subsidiaries | (2,945) | — | — | 2,945 | — |
| (Loss) income before income taxes | (3,905) | (2,842) | (103) | 2,945 | (3,905) |
| Income tax benefit | (1,542) | — | — | — | (1,542) |
| Net (loss) income | <u>\$ (2,363)</u> | <u>\$ (2,842)</u> | <u>\$ (103)</u> | <u>\$ 2,945</u> | <u>\$ (2,363)</u> |

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Cash Flows—Successor
For the six months ended June 29, 2008
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|--|------------------|---------------------------|------------------------------|--------------|-----------------------|
| Operating Activities: | | | | | |
| Net (loss) income | \$ (7,732) | \$ (5,093) | \$ (446) | \$ 5,539 | \$ (7,732) |
| Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities: | | | | | |
| Depreciation and amortization | 4,295 | 4,349 | 90 | — | 8,734 |
| Amortization of deferred financing costs | 554 | — | — | — | 554 |
| Increase in deferred rent, net | 710 | 68 | — | — | 778 |
| Asset impairment, restaurant closings/remodels | — | 335 | — | — | 335 |
| Deferred tax benefit | (5,292) | — | — | — | (5,292) |
| Equity in net loss of unconsolidated affiliates | — | — | 128 | — | 128 |
| Equity in loss of subsidiaries | 5,539 | — | — | (5,539) | — |
| Changes in operating assets and liabilities: | | | | | |
| (Increase) decrease in receivables | 120 | 130 | (453) | — | (203) |
| Decrease in inventories | 129 | 136 | 2 | — | 267 |
| Decrease (increase) in prepaid expenses | 410 | (34) | 3 | — | 379 |
| Increase in other assets | 114 | (2) | — | — | 112 |
| (Decrease) increase in accounts payable and accrued expenses | (2,285) | 71 | 202 | — | (2,012) |
| Decrease in accrued interest payable | (374) | — | — | — | (374) |
| Net cash (used in) provided by operating activities | <u>(3,812)</u> | <u>(40)</u> | <u>(474)</u> | <u>—</u> | <u>(4,326)</u> |
| Investing Activities: | | | | | |
| Purchases of property and equipment | (3,234) | (6,314) | — | — | (9,548) |
| Purchases of other locations | — | (619) | — | — | (619) |
| Investment in joint ventures | (124) | — | — | — | (124) |
| Net cash used in investing activities | <u>(3,358)</u> | <u>(6,933)</u> | <u>—</u> | <u>—</u> | <u>(10,291)</u> |
| Financing Activities: | | | | | |
| Repayment of secured term loan | (915) | — | — | — | (915) |
| Intercompany balances | (6,380) | 5,903 | 477 | — | — |
| Net cash (used in) provided by financing activities | <u>(7,295)</u> | <u>5,903</u> | <u>477</u> | <u>—</u> | <u>(915)</u> |
| Decrease in cash and cash equivalents | (14,465) | (1,070) | 3 | — | (15,532) |
| Cash and cash equivalents at beginning of period | 25,693 | 2,893 | 281 | — | 28,867 |
| Cash and cash equivalents at end of period | <u>\$ 11,228</u> | <u>\$ 1,823</u> | <u>\$ 284</u> | <u>\$ —</u> | <u>\$ 13,335</u> |

Supplemental non-cash financing activities:

In June 2008, the Company entered into a non-cash insurance premium financing agreement for \$3.0 million.

SBARRO, INC. AND SUBSIDIARIES
Notes To Unaudited Consolidated Financial Statements
Consolidating Statement of Cash Flows—Successor
For the period January 31—July 1, 2007
(In thousands)
(Continued)

| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidated Total |
|--|------------------|---------------------------|------------------------------|--------------|-----------------------|
| Operating Activities: | | | | | |
| Net (loss) income | \$ (2,992) | \$ (1,318) | \$ (180) | \$ 1,498 | \$ (2,992) |
| Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities: | | | | | |
| Depreciation and amortization | 3,941 | 3,596 | 1 | — | 7,538 |
| Amortization of deferred financing costs | 244 | — | — | — | 244 |
| Amortization of senior note | 360 | — | — | — | 360 |
| (Decrease)increase in deferred rent, net | (261) | 887 | — | — | 626 |
| Asset impairment, restaurant closings/remodels | — | 208 | — | — | 208 |
| Deferred tax benefit | (2,543) | — | — | — | (2,543) |
| Equity in earnings of subsidiaries | 1,498 | — | — | (1,498) | — |
| Changes in operating assets and liabilities, net of effects of merger: | | | | | |
| Decrease (increase) in receivables | 1,616 | 339 | (42) | — | 1,913 |
| Decrease (increase) in inventories | 43 | (50) | 1 | — | (6) |
| Decrease (increase) in prepaid expenses | 1,220 | 288 | (1) | — | 1,507 |
| (Increase) decrease in other assets | (642) | 1 | — | — | (641) |
| Increase (decrease) in accounts payable and accrued expenses | 1,405 | (614) | 87 | — | 878 |
| Increase in accrued interest payable | 7,817 | — | — | — | 7,817 |
| Net cash provided by (used in) operating activities | <u>11,706</u> | <u>3,337</u> | <u>(134)</u> | <u>—</u> | <u>14,909</u> |
| Investing Activities: | | | | | |
| Purchases of property and equipment | (4,282) | (1,992) | (25) | — | (6,299) |
| Purchases of franchise locations | — | (4,790) | — | — | (4,790) |
| Net cash paid for merger, net of cash acquired | <u>(177,000)</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>(177,000)</u> |
| Net cash used in investing activities | <u>(181,282)</u> | <u>(6,782)</u> | <u>(25)</u> | <u>—</u> | <u>(188,089)</u> |
| Financing Activities: | | | | | |
| Proceeds from shareholders for issuance of common stock | 133,000 | — | — | — | 133,000 |
| Proceeds from secured term loan | 183,000 | — | — | — | 183,000 |
| Proceeds from senior notes | 150,000 | — | — | — | 150,000 |
| Paydown of Predecessor's notes | (267,000) | — | — | — | (267,000) |
| Debt issue costs | (11,000) | — | — | — | (11,000) |
| Repayment of secured term loan | (458) | — | — | — | (458) |
| Intercompany balances | <u>(6,186)</u> | <u>5,575</u> | <u>611</u> | <u>—</u> | <u>—</u> |
| Net cash provided by financing activities | <u>181,356</u> | <u>5,575</u> | <u>611</u> | <u>—</u> | <u>187,542</u> |
| Increase in cash and cash equivalents | 11,780 | 2,130 | 452 | — | 14,362 |
| Cash and cash equivalents at beginning of period | — | — | — | — | — |
| Cash and cash equivalents at end of period | <u>\$ 11,780</u> | <u>\$ 2,130</u> | <u>\$ 452</u> | <u>\$ —</u> | <u>\$ 14,362</u> |

Supplemental non cash investing activities:

On January 30, 2007, the Company transferred its interest of \$5.6 million of certain non-core assets to a newly-formed company owned by certain of our former shareholders.

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

Forward-Looking Statements

We make statements in this Quarterly Report that are considered forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended. The words "anticipate," "believe," "estimate," "intend," "may," "will," "expect" and similar words often indicate that a statement is a "forward-looking statement." Statements about non-historic results also are considered to be forward-looking statements. None of these forward-looking statements are guarantees of future performance or events, and they are subject to numerous risks, uncertainties and other factors. These risks, uncertainties and other factors include, but are not limited to:

- general economic, inflation, national security, weather and business conditions;
- decrease in mall traffic, and other events that signal or arise from a downturn in the economy, such as continued increases in energy and commodity costs that negatively affect consumer spending;
- the availability of suitable restaurant sites in appropriate regional shopping malls and other locations on reasonable rental terms;
- changes in consumer tastes;
- changes in population and traffic patterns, including the effects that military action and terrorism or other events may have on the willingness of consumers to frequent malls, airports or downtown areas which are the predominant areas in which our restaurants are located;
- our ability to continue to attract franchisees;
- the success of our present, and any future, joint ventures and other expansion opportunities;
- the availability of food (particularly cheese and tomatoes), beverage and paper products;
- our ability to pass along cost increases to our customers;
- increases in the Federal minimum wage;
- the continuity of services of members of our senior management team;
- our ability to attract and retain competent restaurant and executive managerial personnel;
- competition;
- the level of, and our ability to comply with, government regulations;
- our ability to generate sufficient cash flow to make interest payments and principal under our borrowing agreements;
- our ability to comply with financial covenants and ratios and the effects the restrictions imposed by those financial covenants and ratios may have on our ability to operate our business; and
- our ability to repurchase and/or repay amounts under our borrowing agreements to the extent required in the event of certain circumstances as defined in our borrowing agreements.

You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report. We do not undertake any responsibility to release publicly any revisions to these forward-looking statements to take into account events or circumstances that occur after the date of this report. Additionally, we do not undertake any responsibility to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in this report.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements, the notes thereto and other data and information appearing elsewhere in this report.

Executive Overview

For the purposes of management's discussion and analysis, the year to date second quarter of 2008 is the six months ended June 29, 2008 and the year to date second quarter 2007 is the combined Predecessor and Successor period of January 1, 2007 through July 1, 2007. The combined results of the Successor and Predecessor for the six months ended July 1, 2007 do not comply with generally accepted accounting principles; however, we believe this provides useful information to discuss the relative performance of the business in all periods presented in the financial statements on an ongoing basis.

We believe we are the world's leading Italian Quick Service Restaurant ("QSR") concept and the largest shopping mall-focused restaurant concept in the world. We have a global base of 1,064 units in 43 countries, with 509 company-owned units, 546 franchised units and 9 joint venture units. Sbarro restaurants feature a menu of popular Italian food, including pizza, a selection of pasta dishes and other hot and cold Italian entrees, salads, sandwiches, drinks and desserts.

We operate our business through two segments. Our company-owned restaurant segment is comprised of the operating activities of our company-owned QSR's and other concept restaurants. Our franchised restaurant segment is comprised of our franchised restaurants which offer opportunities worldwide for qualified operators to conduct business under the Sbarro name and other trade names owned by Sbarro. Our operating segments are discussed in *Note 3—Summary of Significant Accounting Policies and Note 15—Business Segment Information* to our *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 30, 2007.

Our Restaurant Expansion

The following table summarizes the number of company-owned, franchised, and joint venture restaurants in operation during each indicated period:

| | 3 months ended 6/29/08 (Successor) | 3 months ended 7/1/07 (Successor) | 6 months ended 6/29/08 (Successor) | 6 months ended 7/01/07 (Combined) |
|--|---|--|---|--|
| Company-owned Sbarro restaurants: | | | | |
| Open at beginning of period | 504 | 484 | 506 | 485 |
| Opened during period | 4 | 8 | 8 | 10 |
| Acquired from franchisees during period | 1 | 10 | 1 | 11 |
| Closed during period | — | (4) | (6) | (8) |
| Open at end of period | <u>509</u> | <u>498</u> | <u>509</u> | <u>498</u> |
| Franchised Sbarro restaurants: | | | | |
| Open at beginning of period | 528 | 489 | 524 | 478 |
| Opened during period | 29 | 25 | 48 | 40 |
| Transferred to Sbarro during period | (1) | (10) | (1) | (11) |
| Closed during period | (10) | (5) | (25) | (8) |
| Open at end of period | <u>546</u> | <u>499</u> | <u>546</u> | <u>499</u> |
| Joint venture Sbarro restaurants: | | | | |
| Open at beginning of period | 8 | — | 7 | — |
| Opened during period | 1 | 1 | 2 | 1 |
| Closed during period | — | — | — | — |
| Open at end of period | <u>9</u> | <u>1</u> | <u>9</u> | <u>1</u> |
| All restaurants: | | | | |
| Open at beginning of period | 1,040 | 973 | 1,037 | 963 |
| Opened during period | 34 | 34 | 58 | 51 |
| Closed during period | (10) | (9) | (31) | (16) |
| Open at end of period | <u>1,064</u> | <u>998</u> | <u>1,064</u> | <u>998</u> |

Seasonality

Revenues are highest in our fourth quarter due primarily to increased traffic in shopping malls during the holiday shopping season. Our annual revenues and earnings can fluctuate due to the length of the holiday shopping period between Thanksgiving and New Year's Day.

Financial Information (Dollars in millions)

| | Three months ended <u>June 29, 2008</u> (Successor) | Three months ended <u>July 1, 2007</u> (Successor) | Six months ended <u>June 29, 2008</u> (Successor) | Six months ended <u>July 1, 2007</u> (Combined) (2) |
|---|--|---|--|--|
| Comparable sales-percentage change vs. prior comparable period ⁽¹⁾ : | | | | |
| QSR-owned locations | -0.5% | 3.0% | 0.0% | 2.9% |
| Franchise locations: | | | | |
| Domestic Franchise | -1.8% | 4.6% | -0.9% | 4.5% |
| International Franchise | 21.8% | 3.7% | 22.6% | 5.3% |
| Franchised sales ⁽³⁾ | \$ 98.3 | \$ 80.0 | \$ 182.0 | \$ 156.5 |
| Cost of food and paper products as a percentage of restaurant sales | 23.9% | 20.2% | 22.9% | 19.9% |
| Payroll and other benefits as a percentage of restaurant sales | 30.1% | 28.0% | 29.0% | 28.2% |
| Other operating expense as a percentage of restaurant sales | 38.4% | 37.5% | 38.0% | 36.9% |
| General and administrative costs as a percentage of revenues | 8.2% | 8.3% | 8.4% | 8.6% |
| EBITDA ⁽⁴⁾ | \$ 3.9 | \$ 8.7 | \$ 11.1 | \$ (13.3) |

- (1) Comparable and annual percentage changes are based on locations that were open during the entire period within the periods presented.
- (2) The combined results of the Successor and Predecessor for the six months ended July 1, 2007 do not comply with generally accepted accounting principles; however, we believe this provides useful information to discuss the relative performance of the business in all periods presented in the financial statements on an ongoing basis.
- (3) While we do not record franchised sales as revenues, we believe they are important in understanding our financial performance because these sales are the basis on which the company calculates and records franchised royalties and are indicative of the financial health of the franchisee base.
- (4) EBITDA represents earnings before interest income, interest expense, taxes, depreciation and amortization. EBITDA should not be considered in isolation from, or as a substitute for, net income, cash flow from operations or other cash flow statement data prepared in accordance with generally accepted accounting principles ("GAAP") or as a measure of a company's profitability or liquidity. Rather, we believe that EBITDA provides relevant and useful information for analysts of, and investors in, our Senior Notes in that EBITDA is one of the factors in the calculation of our compliance with the ratios in the Senior Credit Facilities. We also internally use EBITDA to determine whether to continue operating restaurant units since it provides us with a measurement of whether we are receiving an adequate cash return on our investment. Our calculation of EBITDA may not be comparable to a similarly titled measure reported by other companies, since all companies do not calculate this non-GAAP measure in the same manner. Our EBITDA calculations are not intended to represent cash provided by (used in) operating activities since they do not include interest and taxes and changes in operating assets and liabilities, nor are they intended to represent a net increase in cash since they do not include cash provided by (used in) investing and financing activities. Included in the calculation of EBITDA for Combined 2007 is \$31.4 million related to a special event bonus.

The following table reconciles EBITDA to our net loss for each of the periods presented, which we believe is the most direct comparable GAAP financial measure to EBITDA (In thousands):

| | Six months ended June 29, 2008 (Successor) | Six months ended July 1, 2007 (Combined)(*) | January 31- July 1, 2007 (Successor) | January 1- January 30, 2007 (Predecessor) | 3 months ended June 29, 2008 (Successor) | 3 months ended July 1, 2007 (Successor) |
|-------------------------------|---|--|---|--|---|--|
| EBITDA | \$ 11,117 | \$ (13,279) | \$ 15,523 | \$ (28,802) | \$ 3,916 | \$ 8,704 |
| Interest Expense | (15,045) | (15,933) | (13,363) | (2,570) | (7,309) | (8,059) |
| Interest Income | 107 | 512 | 404 | 108 | 34 | 72 |
| Income Tax Benefit (Expense) | 4,823 | 1,938 | 1,982 | (44) | 2,994 | 1,542 |
| Depreciation and Amortization | (8,734) | (8,810) | (7,538) | (1,272) | (4,616) | (4,622) |
| Net loss | <u>\$ (7,732)</u> | <u>\$ (35,572)</u> | <u>\$ (2,992)</u> | <u>\$ (32,580)</u> | <u>\$ (4,981)</u> | <u>\$ (2,363)</u> |

(*) The combined results of the Successor and Predecessor for the period in 2007 do not comply with generally accepted accounting principles; however, we believe that this provides useful information to assess the relative performance of the businesses in all periods presented in the financial statements on an ongoing basis. Included in the calculation of EBITDA for combined 2007 is \$31.4 million related to a special event bonus.

The following table sets forth the information concerning the revenue and operating income before unallocated costs of each of our company-owned and franchised restaurant segments:

| | Company- Owned Restaurants(1) | Franchised Restaurants (In thousands) | Totals |
|--|-------------------------------------|---|--------------------|
| 2nd Quarter 2008 (Successor) | | | |
| Total revenue | \$ 81,143 | \$ 4,239 | \$ 85,382 |
| Operating income before unallocated costs | 2,052 | 3,158 | 5,210 |
| Unallocated costs and expenses ⁽²⁾ | | | 5,932 |
| Operating loss | | | <u>\$ (722)</u> |
| 2nd Quarter 2007 (Successor) | | | |
| Total revenue | \$ 78,959 | \$ 3,642 | \$ 82,601 |
| Operating income before unallocated costs | 7,279 | 2,525 | 9,804 |
| Unallocated costs and expenses ⁽²⁾ | | | 5,722 |
| Operating income | | | <u>\$ 4,082</u> |
| YTD 2nd Quarter 2008 (Successor) | | | |
| Total revenue | \$ 160,896 | \$ 7,724 | \$168,620 |
| Operating income before unallocated costs | 9,035 | 5,340 | 14,375 |
| Unallocated costs and expenses ⁽²⁾ | | | 11,864 |
| Operating income | | | <u>\$ 2,511</u> |
| YTD 2nd Quarter 2007 (Combined) ⁽⁴⁾ | | | |
| Total revenue | \$ 155,968 | \$ 7,112 | \$163,080 |
| Operating income before unallocated costs | 16,290 | 4,625 | 20,915 |
| Unallocated costs and expenses ⁽²⁾ | | | 43,016 |
| Operating loss ⁽³⁾ | | | <u>\$ (22,101)</u> |
| 1/31/07 – 7/1/07 (Successor) | | | |
| Total revenue | \$ 132,051 | \$ 6,119 | \$138,170 |
| Operating income before unallocated costs | 13,130 | 4,031 | 17,161 |
| Unallocated costs and expenses ⁽²⁾ | | | 9,176 |
| Operating income | | | <u>\$ 7,985</u> |
| 1/1/07 – 1/30/07 (Predecessor) | | | |
| Total revenue | \$ 23,917 | \$ 993 | \$ 24,910 |
| Operating income before unallocated costs | 3,160 | 594 | 3,754 |

| | |
|---|--------------------|
| Unallocated costs and expenses ⁽²⁾ | <u>33,840</u> |
| Operating loss ⁽³⁾ | <u>\$ (30,086)</u> |

-
- (1) Total revenue includes restaurant sales in the Successor period and restaurant sales and real estate revenues in the Predecessor period.
 - (2) Represents those general and administrative expenses that are not allocated to a segment.
 - (3) 2007 includes \$31.4 million related to a special event bonus.
 - (4) The combined results of the Successor and Predecessor for the periods in 2007 do not comply with generally accepted accounting principles; however, we believe these results provide useful information to assess the relative performance of the businesses in all periods presented in the financial statements on an ongoing basis.

SBARRO, INC. AND SUBSIDIARIES
COMBINED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands)

| | GAAP | | GAAP | | "Combined" | GAAP | |
|--|--|---|--|------------------------------------|--|---|--|
| | Six months ended June 29, 2008 SUCCESSOR | For the period January 31 through July 1, 2007 SUCCESSOR | For the period January 1 through January 30, 2007 PREDECESSOR | Six months ended July 1, 2007 * | Three months ended June 29, 2008 SUCCESSOR | Three months ended July 1, 2007 SUCCESSOR | |
| Revenues: | | | | | | | |
| Restaurant sales | \$ 160,896 | \$ 132,051 | \$ 23,594 | \$ 155,645 | \$ 81,143 | \$ 78,959 | |
| Franchise related income | 7,724 | 6,119 | 993 | 7,112 | 4,239 | 3,642 | |
| Real estate | — | — | 323 | 323 | — | — | |
| Total revenues | 168,620 | 138,170 | 24,910 | 163,080 | 85,382 | 82,601 | |
| Costs and expenses: | | | | | | | |
| Cost of food and paper products | 36,768 | 26,613 | 4,308 | 30,921 | 19,386 | 15,916 | |
| Payroll and other employee benefits | 46,728 | 37,091 | 6,762 | 43,853 | 24,415 | 22,118 | |
| Other operating costs | 61,200 | 48,604 | 8,839 | 57,443 | 31,191 | 29,605 | |
| Other income, net | (1,901) | (1,131) | (497) | (1,628) | (682) | (706) | |
| Depreciation and amortization | 8,734 | 7,538 | 1,272 | 8,810 | 4,616 | 4,622 | |
| General and administrative | 14,245 | 11,261 | 2,843 | 14,104 | 7,010 | 6,838 | |
| Special event bonuses | — | — | 31,395 | 31,395 | — | — | |
| Asset impairment and restaurant closings/remodels | 335 | 209 | 74 | 283 | 168 | 126 | |
| Total costs and expenses net | 166,109 | 130,185 | 54,996 | 185,181 | 86,104 | 78,519 | |
| Operating income (loss) | 2,511 | 7,985 | (30,086) | (22,101) | (722) | 4,082 | |
| Other (expense) income: | | | | | | | |
| Interest expense | (15,045) | (13,363) | (2,570) | (15,933) | (7,309) | (8,059) | |
| Interest income | 107 | 404 | 108 | 512 | 34 | 72 | |
| Equity in net income (loss) of unconsolidated affiliates | (128) | — | 12 | 12 | 22 | 0 | |
| Net other expense | (15,066) | (12,959) | (2,450) | (15,409) | (7,253) | (7,987) | |
| Loss before income taxes | (12,555) | (4,974) | (32,536) | (37,510) | (7,975) | (3,905) | |
| Income tax (benefit) expense | (4,823) | (1,982) | 44 | (1,938) | (2,994) | (1,542) | |
| Net loss | \$ (7,732) | \$ (2,992) | \$ (32,580) | \$ (35,572) | \$ (4,981) | \$ (2,363) | |

* The combined results of the successor and predecessor for the periods in 2007 do not comply with generally accepted accounting principles; however, we believe these results provide useful information to assess the relative performance of the businesses in all periods presented in the financial statements on an ongoing basis.

Second Quarter 2008 versus Second Quarter 2007

Restaurant sales increased by 2.7% to \$81.1 million for the three months ended June 29, 2008 compared to \$79.0 million for the three months ended July 1, 2007. The increase in sales is due to sales generated by new stores opened in 2007 and 2008 of \$2.4 million offset by a slight decrease in comparable unit sales of .5% in our QSR restaurants.

Franchise related income increased to \$4.2 million for the second quarter of 2008 from \$3.6 million for the second quarter of 2007 due to new stores opened in 2007 and 2008 and royalties on increased international comparable unit sales, partially offset by stores closed.

Cost of food and paper products as a percentage of restaurant sales increased to 23.9% for the second quarter of 2008 compared to 20.2% for the second quarter of 2007. The cost of cheese in the second quarter of 2008 averaged \$2.12 per pound compared to an average of \$1.75 per pound in the second quarter of 2007. This \$.37 per pound increase in cheese costs accounted for \$.7 million or .8% of the total percentage of restaurant sales increase. The cost of flour in the second quarter 2008 averaged \$.59 compared to \$.19 in the second quarter 2007. The \$.40 per pound increase accounted for \$1.3 million or 1.7% of the total percentage of restaurant sales increase. The remaining increase as a percentage of restaurant sales relates to fuel surcharges and cost increases on other products including pasta, oil, sausage and pepperoni.

Payroll and other employee benefits as a percentage of restaurant sales increased to 30.1% in the second quarter of 2008 from 28.0% in the second quarter of 2007. The increase is primarily related to higher wages, including minimum wage increases and increased staffing levels at some stores, while sales remained relatively flat.

Other operating costs as a percentage of restaurant sales increased to 38.4% in the second quarter 2008 as compared to 37.5% in the second quarter of 2007. The increase is primarily due to annual increases in occupancy related charges while sales remained relatively flat.

Other income, net was \$.7 million for each of the second quarter of 2008 and 2007, respectively.

Depreciation and amortization remained flat at \$4.6 million for the second quarter of 2008 and 2007, respectively.

General and administrative expenses were relatively flat at \$7.0 million in the second quarter 2008 as compared to \$6.8 million in the second quarter of 2007.

Interest expense of \$7.3 million for the second quarter of 2008 and \$8.1 million for the second quarter of 2007 relates primarily to the Senior Notes and the Term Loan under our Senior Credit Facility. The decrease in interest expense is due to a decrease in the interest rate on the Term Loan. Included in interest expense in the second quarter 2008 and the second quarter of 2007 was the amortization of deferred financing costs for the Senior Notes and Term Loan of \$.3 million and \$.4 million, respectively.

Equity in net income of unconsolidated affiliates relates to our joint venture in Beirut.

In our Successor period after January 31, 2007, we are taxed as a C Corporation. The income tax benefit was \$3.0 million for the second quarter of 2008 and our effective tax rate was 37.5%. The income tax benefit was \$1.5 million for the second quarter of 2007 and our effective tax rate was 39%.

Net loss was \$5.0 million for the second quarter of 2008 as compared to a net loss of \$2.4 million in the second quarter of 2007. The increase in net loss is due to the items discussed above, primarily increased costs while comparable sales remained relatively flat.

Year to Date 2008 Versus 2007

Restaurant sales increased by 3.4% to \$160.9 million for the six months ended June 29, 2008 compared to \$155.6 million for the combined six months ended July 1, 2007. The increase in sales is due to sales generated by new stores opened in 2007 and 2008 of \$5.2 million slightly offset by stores closed, while comparable unit sales remained flat.

Franchise related income increased to \$7.7 million for the first half of 2008 compared to \$7.1 million in the combined first half of 2007 due to royalties on increased international comparable unit sales, partially offset by stores closed.

Cost of food and paper products as a percentage of restaurant sales increased to 22.9% for first half of 2008 compared to 19.9% for the combined first half of 2007. The cost of cheese in the first half of 2008 averaged approximately \$2.14 per pound compared to an average of approximately \$1.64 per pound in the combined first half of 2007. This \$.50 per pound increase in cheese costs accounted for \$1.8 million or 1.5% of the total percentage of restaurant sales increase. The cost of

flour in the first half of 2008 averaged \$.42 compared to \$.21 in the combined first half of 2007. The \$.21 per pound increase accounted for \$1.4 million or .9% of the total percentage of restaurant sales increases. The remaining increase as a percentage of restaurant sales relates to fuel surcharges and cost increases on other products including pasta, oil, sausage and pepperoni.

Payroll and other employee benefits as a percentage of restaurant sales increased to 29.0% in the first half of 2008 from 28.2% in the combined first half of 2007. The increase is primarily related to higher wages, including minimum wage increases and increased staffing levels at some stores, while sales remained relatively flat.

Other operating costs as a percentage of restaurant sales increased to 38.0% in the first half of 2008 as compared to 36.9% in the combined first half of 2007. The increase is primarily due to annual increases in occupancy related charges while sales remained relatively flat.

Other income, net was \$1.9 million for the first half of 2008 compared to \$1.6 million in the combined first half of 2007.

Depreciation and amortization remained relatively flat at \$8.7 million in first half of 2008 compared to \$8.8 million for the combined first half of 2007.

General and administrative expenses remained relatively flat at \$14.2 million in the first half 2008 as compared to \$14.1 million in the combined first half of 2007.

In our Predecessor period in 2007, in connection with the Merger, special event bonuses paid were \$31.4 million.

Interest expense of \$15.0 million for the first half of 2008 and \$15.9 million for the combined first half of 2007 relates primarily to the Senior Notes and the Term Loan under our Senior Credit Facility. The decrease in interest expense is due to a decrease in the interest rate on the Term Loan. Included in interest expense in the first half 2008 and 2007 was the amortization of deferred financing costs for the Senior Notes and Term Loan of \$.6 million in each period. In our Predecessor period in 2007, interest expense related to the 11%, \$255 million senior notes and the 8.4%, \$16 million mortgage loan on our corporate headquarters. In connection with the Merger, the 11% Notes were redeemed and the mortgage loan and interests in our corporate headquarters were transferred to a company owned by certain of our former shareholders.

Equity in net loss of unconsolidated affiliates relates to our joint venture in Beirut.

In our Successor period after January 31, 2007, we are taxed as a C Corporation. The income tax benefit was \$4.8 million for the first half of 2008 and our effective tax rate was 38.4%. The income tax benefit was \$2.0 million for the period January 31 through July 1, 2007 (Successor) and our effective tax rate was 39% for that period. Prior to January 31, 2007, we were taxed under the provisions of Subchapter S of the Internal Revenue Code and, where applicable and permitted, under similar state and local income tax provisions. Under the provisions of Subchapter S, substantially all taxes on our income were paid by our former shareholders rather than by the Company.

Net loss was \$7.7 million for the first half of 2008 as compared to a \$35.6 million net loss in the combined first half of 2007. Included in the combined first half of 2007 net loss was \$31.4 attributable to special event bonus in connection with the Merger. After adjusting for the special event bonus, the increase in the net loss is due to the items discussed above, primarily an increase in costs while comparable sales remained relatively flat.

Liquidity and Capital Resources

Principal Cash Requirements and Sources

Our liquidity requirements relate to debt service, capital expenditures, working capital, investments in other ventures, and acquisitions. We estimate that our annual cash interest expense under the Senior Notes and Senior Credit Facilities that we put into place in connection with the Merger will be approximately \$27 million. We also may incur additional interest expense for borrowings under our line of credit. The Senior Credit Facilities require us to prepay outstanding borrowings, subject to certain exceptions, with (a) 50% of our annual excess cash flow (subject to step-downs based upon our total leverage ratio); (b) 100% of the net cash proceeds of certain asset sales or other dispositions of property (including casualty insurance and condemnations) if we do not commit to reinvest such proceeds in accordance with the terms of the Senior Credit Facilities within 365 days of the event giving rise thereto (or, to the extent we have entered into a commitment to reinvest such proceeds within such time period to the extent such amounts are actually reinvested, within six months of the expiration of such 365 days); and (c) 100% of the net cash proceeds of any incurrence of debt, other than debt permitted under the Senior Credit Facilities. We are not required to make principal payments, absent the occurrence of certain events, on our Senior Notes until they mature in 2015. In the first half of 2008, we purchased two QSR locations for approximately

\$.6 million, invested approximately \$.6 million in joint ventures and we repaid \$.9 million in principal per the terms of our Term Loan. We believe that aggregate capital expenditures for all of 2008 will approximate \$18 million which we expect will be funded with operating cash.

Based on our current level of operations, we believe our cash flow from operations, available cash and available borrowings under our Senior Credit Facilities will be adequate to meet our liquidity needs for at least the next twelve months.

Contractual Obligations

Our contractual obligations do not materially differ from the information disclosed in Part II, Item 7 of our Annual Report Form 10-K for the year ended December 30, 2007.

Sources and Uses of Cash

The following table summarizes our cash and cash equivalents and working capital as at the end of the first half of 2008 and 2007 and the sources and uses of our cash flows during the first half of each of those years (in millions):

| | <u>June 29, 2008</u> | <u>December 30, 2007</u> | |
|--|---|--|--|
| Liquidity at the end of period | | | |
| Cash and cash equivalents | \$ 13.3 | \$ 28.9 | |
| Working capital | (17.6) | (4.9) | |
| | <u>Six Months Ended June 29, 2008 (Successor)</u> | <u>Period Jan. 31 - July 1, 2007 (Successor)</u> | <u>Period Jan. 1 - Jan. 30, 2007 (Predecessor)</u> |
| Net cash flows | | | |
| (Used in) provided by operating activities | \$ (4.3) | \$ 14.9 | \$ (5.3) |
| Used in investing activities | (10.3) | (199.0) | (1.7) |
| (Used in) provided by financing activities | (.9) | 198.5 | (70.6) |
| Net (decrease) increase in cash | <u>\$ (15.5)</u> | <u>\$ 14.4</u> | <u>\$ (77.6)</u> |

We have not historically required significant working capital to fund our existing operations and have financed our capital expenditures and investments in joint ventures through cash generated from operations. Since restaurant businesses do not have large amounts of inventory and accounts receivable, there is generally no need to finance such items. As a result, we like many other restaurant businesses, may operate with negative working capital. The decline in working capital resulted primarily from lower earnings from operations in the first half of 2008, as well as a decline in cash resulting from interest payments, debt repayments and capital expenditures. Cash flow from current operations and our line of credit supports our working capital needs.

Net cash used in operating activities was \$4.3 million during the six months ended June 29, 2008 and primarily related to the net loss in the first half of 2008. Net cash provided by operating activities was \$14.9 million in the Successor period January 31 through July 1, 2007 and \$5.3 million used in the Predecessor period January 1 through January 30, 2007.

Net cash used in investing activities of \$10.3 million for the six months ended June 29, 2008 was mostly related to capital expenditures utilized primarily for restaurant openings and renovation activity. Net cash used in investing activities was \$199.0 million for the Successor period January 31 through July 1, 2007 the majority of which was \$188 million net cash paid for the Merger and \$6.3 million for capital expenditures. Net cash used in investing activities was \$1.7 million for the Predecessor period January 1 through January 30, 2007.

The cash used in financing activities was \$.9 million for the six months ended June 29, 2008 which was for principal payments on our Term Loan. The net cash provided by financing activities for the Successor period January 31 through July 1, 2007 was \$198.5 million and represents proceeds from injected capital, the proceeds from the new debt, debt issue costs and the paydown of the old debt. Net cash used in financing activities for the Predecessor period of January 1 through January 30, 2007 of \$70.6 million represents dividends to our former shareholders net of repayments of officer loans.

Critical Accounting Policies and Judgments

Accounting policies are an integral part of the preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America. Understanding these policies, therefore, is a key factor in understanding our reported results of operations and financial position. Accounting policies often require us to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in our financial statements. Due to their nature, estimates involve judgments based upon available information. Therefore, actual results or amounts could differ from estimates and the difference could have a material impact on our consolidated financial statements.

During the six months ended June 29, 2008, there were no changes in the accounting policies whose application may have the most significant effect on our reported results of financial position and that require judgments, estimates, and assumptions by management that can affect their application and our results of operations and financial position from those discussed under the heading “Critical Accounting Policies and Judgments” in Part II Item 7 of our Annual Report on Form 10-K for the year ended December 30, 2007.

Goodwill and Other Intangible Assets

Due to the seasonality of our business, until we determine the results of operations for our fourth quarter, we are not able to perform our annual test for impairment on our goodwill and intangible assets with indefinite lives as required by SFAS No. 142, “Goodwill and Other Intangible Assets,” and fully evaluate the impairment of long-lived assets as required by SFAS No. 144, “Accounting for the Impairment and Disposal of Long-Lived Assets.” Any required adjustments are recorded at that time unless impairment factors become evident earlier.

Recent Accounting Pronouncements

During the six months ended June 29, 2008, there were no recent accounting pronouncements that had a material effect on our consolidated financial statements. Refer to *Note 2 – Recent Accounting Pronouncements* to our unaudited consolidated financial statements for further discussion.

Certain Relationships and Related Transactions

As of June 29, 2008, our consolidated joint venture has a loan payable to a company related to a shareholder of the joint venture for \$500 thousand.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to certain risks which exist as part of our ongoing business operation.

We have not purchased future, forward, option or other instruments to hedge against fluctuations in the prices of commodities. As a result, our future commodities purchases are subject to changes in the prices of such commodities. We have entered and sometimes will enter into short-term, fixed rate contracts for some products we purchase.

Interest Rate Risk

We currently invest our cash on hand in FDIC insured overnight cash management savings accounts earning interest based on the 91-day Treasury bill rates. The indenture governing the Senior Notes limits the nature of our investments to those of lower risk. Although our existing investments are not considered at risk with respect to changes in interest rates or markets for these instruments, our rate of return on short-term investments could be affected at the time of reinvestment as a result of intervening events.

The interest rate on borrowings under our Senior Credit Facilities is floating and, therefore, is subject to fluctuations. In general, borrowings under the Senior Credit Facilities bear interest based, at our option, at either the Eurodollar rate or an alternative base rate (“ABR”), in each case plus a margin. The applicable margin will be based on our total leverage ratio (as defined in the credit agreement governing the Senior Credit Facilities) at the time of determination. Currently, our rate of interest for borrowings under the Senior Credit Facilities is LIBOR plus 2.50% or ABR plus 1.50%. A 1% change in our current rate would have an annual effect of approximately \$1.8 million. Subsequent to the Merger, we entered into an Interest Rate Cap Letter Agreement with a bank for a portion of our Senior Credit Facility. This agreement caps our LIBOR rate at 6.00% through February 2009 and 6.50% through February 2010.

Foreign Exchange Rate Risk

All of our transactions with foreign franchisees have been denominated in, and all payments have been made in, United States dollars, thereby reducing the risks in the changes of the values of foreign currencies. As a result, we have not purchased future contracts, options or other instruments to hedge against changes in values of foreign currencies.

Item 4T. Controls and Procedures

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be met. As there are inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within our Company have been detected. Inherent limitations include human errors or misjudgments. Controls also can be circumvented by the intentional acts of individuals or groups.

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in our periodic filings under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including those officers, to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended June 29, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Legal proceedings included in our Annual Report on Form 10-K for the year ended December 30, 2007 in Note 10 to the Notes to Consolidated Financial Statements have not materially changed.

Item 1A. Risk Factors

The risk factors included in our Annual Report on Form 10-K for the year ended December 30, 2007 have not materially changed. You should consider carefully the risks described under *Item 1A Risk Factors* in our Annual Report on Form 10-K for the year ended December 30, 2007. The risks and uncertainties described in our Annual Report on Form 10-K for the period ended December 30, 2007 are not the only ones that may affect us. If any of the events described actually occur, our business and financial results could be materially adversely affected.

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

None.

Item 3. Default upon senior securities

None.

Item 4. Submission of matters to a vote of security holders

None.

Item 5. Other information

None.

Item 6. Exhibits

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|---|
| *3.1 | Restated Certificate of Incorporation of Sbarro, Inc. (Exhibit 3.1 to our Registration Statement on Form S-4, File No. 333-142081) |
| *3.2 | Amended and Restated Bylaws of Sbarro, Inc. (Exhibit 3.2 to our Registration Statement on Form S-4, File No. 333-142081) |
| *4.1 | Indenture dated as of January 31, 2007 among MidOcean SBR Acquisition Corp., Sbarro, Inc., the subsidiary guarantors party thereto from time to time and the Bank of New York, as trustee. (Exhibit 4.1 to our Registration Statement on Form S-4, File No. 333-142081) |
| *4.2 | Registration Rights Agreement dated January 31, 2007 among Sbarro, Inc., Credit Suisse Securities (USA) LLC and Banc of America Securities LLC, as Initial Purchasers. (Exhibit 4.2 to our Registration Statement on Form S-4, File No. 333-142081) |
| 31.01 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.02 | Certification of Vice President, Chief Financial Officer and Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| **32.01 | Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| **32.02 | Certification of Vice President, Chief Financial Officer and Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Incorporated by reference to the document indicated.

** These certifications are being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and are not being filed as part this Quarterly Report on Form 10-Q or as a separate disclosure document.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SBARRO, INC.
Registrant

Date: August 8, 2008

By: /s/ Peter Beaudrault
Peter Beaudrault,
Chairman of the Board of Directors,
President and Chief Executive Officer

Date: August 8, 2008

By: /s/ Anthony J. Puglisi
Anthony J. Puglisi
Vice President,
Chief Financial Officer and
Principal Accounting Officer

EXHIBIT INDEX

Item 6. Exhibits

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* Incorporated by reference to the document indicated.

** These certifications are being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and are not being filed as part this Quarterly Report on Form 10-Q or as a separate disclosure document.

CERTIFICATION

I, Peter Beaudrault, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sbarro, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Peter Beaudrault

Peter Beaudrault

Chairman of the Board of Directors,

President and Chief Executive Officer

(Principal Executive Officer)

CERTIFICATION

I, Anthony J. Puglisi, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sbarro, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Anthony J. Puglisi

Anthony J. Puglisi

Vice President and Chief Financial Officer

(Principal Accounting Officer)

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

In connection with the Quarterly Report of Sbarro, Inc. (the "Company") on Form 10-Q for the period ended June 29, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter Beaudrault, Chief Executive Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that to my knowledge:

- (1) The Report fully complies with the requirements of Section 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 8, 2008

/s/ Peter Beaudrault

Peter Beaudrault
Chairman of the Board of Directors,
President and Chief Executive Officer
(Principal Executive Officer)

NOTE: A signed original of this certification has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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

In connection with the Quarterly Report of Sbarro, Inc. (the "Company") on Form 10-Q for the period ended June 29, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Anthony J. Puglisi, Vice President-Chief Financial Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that to my knowledge:

- (1) The Report fully complies with the requirements of Section 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 8, 2008

/s/ Anthony J. Puglisi

Anthony J. Puglisi
Vice President and Chief Financial Officer
Principal Financial Officer

NOTE: A signed original of this certification has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.