

## Bankruptcy: Who's next in line?

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Stop us if you've heard this one: The owner of a pair of food franchises, struggling amidst rising costs and fewer customers, filed bankruptcy after failing to work out its financial problems.

This time, the company was Mrs. Fields Brands, the owner of the venerable Mrs. Fields cookie chain and the TCBY frozen yogurt system. Unable to get out under the weight of its significant debt load, the franchisor filed for Chapter 11 bankruptcy protection in August.

It is only the latest in a string of bankruptcies among large restaurant systems, including the owner of Benigan's and Steak & Ale; the Colorado-based owner of the non-franchised Bakers Square and the franchised Village Inn chains; and Minnesota-based Buffets Inc., have each sought debt protection.

And, apparently, they may not be the last:

Uno Chicago Grill, the Boston-based chain of more than 200 pizzerias, is working to restructure its debt while both Standard & Poor's and Moody's Investors Service each lowered its ratings after the company delayed a bond payment. Company officials, however, say they have the cash to make the payment.

The mall-based, pizza chain Sbarro is also apparently in trouble. Both S&P and Moody's downgraded its debt rating, citing a possibility that the company — which lost \$7.7 million in the first six months of the year — is facing a possible default.

According to reports, both the Chevy's Fresh Mex chain and the owner of Perkins' and Marie Callendars are trying to renegotiate debt.

And it's not just franchisors, either. Franchisees have increasingly been filing for bankruptcy, said Adam Siegelheim, a franchise attorney with the law firm of Stark & Stark. Large owners of Pizza Hut, Waffle House and Famous Dave's have recently filed for debt protection.

While the aforementioned chains may or may not seek debt protection, many restaurant analysts do expect more bankruptcies in the near future, along with additional restaurant closings, amid a challenging environment for the industry as a whole. Ron Paul, president of the restaurant-consulting firm Technomic, believes 1,000 units could close before all is said and done.

That may yield what amounts to be a correction. Paul believes that too many banks, flush with cash to lend, gave too much money to too many restaurants. The market saturation is hammering concepts that many consider "tired" or "old" — notably casual and family dining chains. "There are too many seats, and not enough butts," Paul said.

That economy has hit both franchisors and franchisees on both sides of the financial ledger. And if it's not the main reason for the spate of bankruptcies, it certainly is a major factor.

Siegelheim noted that many of his clients report they're struggling to keep weeknight business as consumers cut back on week-day dining out.

Still, the restaurants struggling are the ones that were having problems going into the tightening economy. Many simply had huge amounts of debt to begin with. Others borrowed heavily shortly before the market turned south, as Uno did in 2005 with a leveraged buyout.

In some cases, said New York-based restaurant analyst Malcolm Knapp, restaurant chains — especially those owned by venture capital firms — used sale-leasebacks to take money out of real-estate holdings. That generated cash, but increased operating costs for the individual units.

A strong economy can be forgiving of such steps. The current economy isn't so forgiving — it can be tough to pay bills when you're not making as much money as you once did. And the more bills you have, the less likely you'll be able to pay them when the economy goes south.

“People who are well capitalized can go through times and come out fine,” said Knapp. He noted that years ago Wendy's hit a rough patch and made it through largely because it had strong finances when the market went south.

“When you don't have a proper capital structure, you're going to get killed in a downturn.” Knapp and other analysts believe that it'll be some time before the restaurant economy improves.

Revelations that Uno is negotiating its debt payment led to speculation that it could be next on the bankruptcy block, but Chief Financial Officer Louis Psallidas said the company will be able to make its debt payment, even if it can't reach a deal with its creditors. Psallidas added that the company wants to renegotiate its debt so it can expand and further its efforts to expand into other markets. The company has an express concept in BJ's Wholesale Clubs and is trying out a fast-casual concept, Uno Due Go. It also has a burgeoning grocery business.

“We're trying to get out in front of where the industry is heading,” Psallidas said. “We're trying to reorganize our capital structure to provide liquidity for growth.”

Mrs. Fields, however, could not avoid bankruptcy. The company has liabilities of \$261 million, nearly double its assets of \$135 million. The interest on its debt alone is more than \$21 million, or nearly a quarter of its annual revenues of roughly \$90 million. The company had this debt despite selling two pretzel brands and its Great American Cookies brand to NexCen Brands for a total of \$111 million plus stock in two separate deals.

John Lauck, one of the two co-CEOs, said in a statement that he considers the bankruptcy an “administrative matter,” and that the company expects to emerge from bankruptcy well before the start of the Christmas shopping season. “We have every confidence that the company will emerge from Chapter 11 a more vital company ready to achieve strong growth in the future,” he said.