

OUTLOOK

Franchisee of the Year

Abolghassem “Abe” Alizadeh was living the American dream: An immigrant with little command of English found work in a Jack in the Box restaurant, became a manager, bought the franchise and 30 years later had 70 restaurants and 3 million square feet of office and retail properties—enough money to live happily ever after, or so it would seem.

Alizadeh was at the top of the business world, flush with money, power and respect. But now the dream has turned into nightmare for him and his family, brought on by his overzealous speculation on real estate, too much debt and a brutal economy that rewarded neither.

Alizadeh is no longer in control of his restaurants or his massive real estate holdings after court-appointed trustees replaced him following his bankruptcy filings. Most of his property developments have been taken back by banks or sold. Last month, 66 of his Jack in the Box restaurants were put on the auction block in Sacramento and sold by a trustee for \$39 million.

In his more reflective moments, Alizadeh acknowledges the debt he took on too quickly caused the implosion of his restaurant and real estate holdings. Yet he also vents, and most of his ire is directed at Jack in the Box, who according to Alizadeh, gladly cashed his checks when times were good, but abandoned him when his survival was on the line. “Thirty-two years of contribution and now 18 months of troubles and they drop me,” Alizadeh said.

He is also proud, sure that he still can run a good restaurant and still basking in his accomplishments. And, he believes he will emerge from the ashes of his former business as the victor. He will keep some properties and start over again. He and members of his family will make an offer directly to the court for his restaurants that will beat other bidders. And if that doesn’t work, he’ll become a franchisee in another system and rise again.

To those charged with unraveling Alizadeh’s complex holdings and the debt structure that held them together, Alizadeh’s bravado rings hollow. David Honig, a bankruptcy attorney representing the U.S. Trustee appointed in the franchise case, calls Alizadeh’s plan to buy back his restaurants an example of Alizadeh’s “grandiosity.”

But, to those who know him well, Alizadeh should never be counted out. “Abe is smart and personable and will make a comeback,” said John Ramsay, former vice president of franchising for Jack in the Box.

The Taco Man rises

Abe Alizadeh is a local legend around Roseville, California. He arrived in 1977, a 17-year-old in search of an education he could use to help with his family’s vast landholdings back in Iran.

He learned English making tacos at a local Jack in the Box, where he earned the nickname “Taco Man.” The Taco Man rose through the ranks at the store with hard work and enthusiasm, eventually becoming a store manager so talented customers thought he owned the place. Indeed, he bought the store in 1986.

He quickly expanded his holdings and brought family members over from Iran to work with him. His sister, Kobra, is the namesake and a partner on most of the 30 companies Alizadeh owned. His brother Mike is a partner on some of the restaurants, including a casual dining place they opened together. His sisters Mitra, Azita and Parveneh Alizadeh are also involved in the business.

In 1988, Alizadeh and Kobra formed Kobra Properties to build and own the real estate for the Jack in the Box restaurants. By the early 1990s, they pooled their money to expand into property development. They didn’t want to keep all their eggs in the Jack in the Box basket after the 1990-91 recession and a 1993 E. coli infection that hammered Jack in the Box sales.

Alizadeh’s company took two divergent paths, one to develop franchise restaurants, the other to develop real estate. Both were tremendously successful for a time.

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FINANCE SOURCES

Excess Space Helps Companies Prune Bad Sites

Excess Space's name says it all: Its primary business is real estate disposition and lease restructuring for multi-unit retail companies, including the restaurant sector. Excess Space was founded in 1992 by its current President/CEO **Michael Wiener**, according to **Al Williams**, principal with Excess Space. "Michael recognized that most retailers weren't actively attempting to mitigate the liability associated with surplus real estate. For the most part, they were just sitting on it."

In its beginnings as a disposition firm, Excess Space offered a service that, until its founding, did not really exist, said Williams. He said it allowed the company to create the base model for the disposition industry as it worked to reduce its client's occupancy costs. As Excess Space has refined its business model, this model has become, in his terms, "best-in-class." Developing and working with a broker network that includes more than 450 brokerage firms nationwide, the company, in addition to its ability to market property on regional and national levels, provides its clients with professionals who offer local knowledge and expertise in any geographic locale in the United States and Canada. Further refinements to the model include increased sophistication in due diligence, management of local brokers, and analytical processes.

Williams, who has been with the company since 1996 and serves on the company's board of directors, said there are numerous reasons retailers have surplus real estate beyond unprofitable locations, including mergers and acquisitions, underperforming locations, relocations, downsizings, change in prototype or availability of adjacent land or buildings.

"Really, we are asset optimization experts, which is truly a niche expertise," Williams said. Excess Space has grown from a disposition specialty firm to a full-service asset optimization firm offering diverse programs such as lease restructuring, lease renewal, sale of owned properties, sale of operating units, bulk transactions and real estate valuation, in addition to the disposition of leased properties. "Our company's overriding goal is to reduce a client's real estate obligations and occupancy costs, thereby improving the client's economic position," he added.

Excess Space does not work with retailers that have filed for Chapter 11 bankruptcy protection, a distinguishing feature among many businesses in the disposition specialty. Williams notes that landlords are approached in a more aggressive manner during a bankruptcy, as the bankruptcy code offers real estate consultants significant leverage in their negotiations. These bankruptcy negotiations are analogous to a bull in a china shop, he said.

"It was clearly a line of business we could have started when we launched the business, but decided not to," he explained. "When companies are in Chapter 11, there is a whole different rule book. If someone hires us, we take the approach that if they win, we win, not if they lose (by going bankrupt), we win even bigger by handling the bankruptcy. Additionally, many publicly traded companies don't want to communicate to Wall Street that they have engaged a company that specializes in

bankruptcy, as it can send the wrong message."

Working exclusively outside of bankruptcy, Excess Space is greeted more warmly by a landlord, which he feels only helps the negotiations. Williams further indicates that these negotiations are quid pro quo, meaning the needs of both the retailer and landlord are investigated to work toward a resolution that is acceptable to both parties

"We have spent more than 18 years cultivating our highly developed processes and are proud to say we have worked with over 140 retailers and have put over \$3.5 billion in capital back to work for our clients." Additionally, Excess Space has developed a technological infrastructure that is unique to the industry and streamlines the process significantly for its clients.

"The good news is that this is literally all we do for a living, so we better be good at it," he said. For more information on Excess Space, contact Al Williams, principal, at (714) 594-9800, or by e-mail at aw@excessspace.com.

Largest Taco Bell Franchisee Receives \$78 Million in Funding

Tacala, LLC, the largest Taco Bell franchisee with 161 units, recently closed on a \$78.1 million financing transaction. **Wells Fargo Restaurant Finance** acted as administrative agent and lead arranger, while **Regions Bank**, **Bank of America** and **First Tennessee** also took part in the funding.

The deal consisted of a revolver, development line and five-year term loan. The company will use the proceeds to refinance existing bank and securitized debt and to recapitalize.

Wells Fargo Restaurant Finance provides capital to corporate restaurant brands, multi-unit restaurant franchisees, private equity firms and other financial investors in restaurant concepts. For more information, contact **Nick Cole**, executive vice president, at (760) 918-2705, or by e-mail at james.n.cole@wellsfargo.com.

Bank of America's restaurant group provides debt capital to the franchise sector, including development financing, acquisition financing, cash management services, merchant services, personal banking and investments. For more information, contact **Dan Holland**, managing director, at (404) 607-5844, or by e-mail at daniel.r.holland@baml.com.

Regions Bank's restaurant practices provides financing to multi-unit restaurant companies including capital for acquisitions, development and re-imaging. For more information, contact **Randy Schultz**, managing director at 770-777-6162, or by e-mail at randy.schultz@regions.com.

ADD Realty Launches to Help Refinance Restaurant Operators

This is how entrepreneurs come up with an idea: They see a problem and find a solution. That was the case with **Verdad Realty's Jason Keen** and **Michael Mallick** of the **Mallick Group**.

"Historically, franchisees have grown through acquisitions, and they were acquiring sites every couple of years," said Keen. Now balloon payments for those first acquisitions are coming due and access to refinancing capital is nowhere to be found.

This puts franchisees into technical default for all the assets, even though their newer loans are not due yet, he explained. "They are cross defaulted and that doesn't mean they are bad loans, or the restaurants are not performing. There's not necessarily something wrong with their balance sheet or liquidity. This is what led us to where we are at with **ADD Realty**."

Verdad's Keen joined forces with Mallick to form ADD Realty, which provides capital solutions to franchisees and franchisors of QSR and casual dining concepts. Verdad itself provides new construction, build-to-suit turnkey solutions to franchisees and franchisors, including sale/leaseback financing. Mallick Group is a developer and investor in various forms of real estate, also providing investor groups with real estate investment opportunities.

Keen and Mallick have known each other for years, and have done business together before. Mallick's focus has been on hospitality, land development, public inner city residential and multi-use partnerships and office retail investing.

"Jason offered me the opportunity to invest in some of these deals," explained Mallick. "He noted there was a void in the market, and I wanted to deploy capital."

For the two, it is a good partnership. Mallick takes care of the structured finance and acquisitions, while Keen focuses on the franchisee relationship. In 2009, the duo worked on putting together the structure of ADD and launched it two months ago. The goal is to build \$250 million to \$350 million in investments over the next 18 to 24 months.

In some instances, ADD Realty provides the franchisee with the opportunity to capitalize on the inverse relationship between debt amortization and increasing occupancy costs. "As they have declining amortization and escalating rents, we have the opportunity to buy the debt at book value or at their current debt balance and restructure their leases," Keen explained. Franchisors often are in the same predicament as franchisees with some of their locations, and will work with them to refinance those sites.

They also provide remodeling capital as franchisees struggle to access funding to stay in compliance with their franchise development agreement. "Sometimes they've funded growth, but have not stockpiled their cash and planned ahead for remodels," he added. And ADD Realty also works with lenders who want to clean up their books with defaults and nonperforming loans.

"We will look at each individual asset and the rent to sales ratio," said Mallick. "Whereby their credit may be marginal, the mere application of going through our program will strengthen their overall financial ability. We will work with

some marginal credits."

"It's a chance to help the franchisee improve their financial situation and become healthy," said Keen. For more information on ADD Realty, contact Jason Keen, principal with Verdad Real Estate, at 817-912-0222 or by e-mail at jkeen@verdadrealestate.com.

Wells Fargo Funds Deals

Wells Fargo Restaurant Finance recently provided a \$15 million revolving line of credit to **Caribou Coffee**, which is headquartered in Minneapolis, Minn. The company intends to use the financing for working capital, capex, and other corporate purposes.

Caribou Coffee was founded in 1992, and has 413 corporate and 118 franchised locations.

Wells also provided \$21.05 million to **CFRA, LLC**, in the form of a revolver and five-year term loan. CFRA is a 43-unit IHOP franchisee which is owned by funds managed by Prometheus Partners. The company has locations in North Carolina, South Carolina, Tennessee, Alabama and Virginia. CFRA will use the proceeds to acquire three existing IHOP locations and for refinancing/recapitalization.

And a \$6.8 million term loan was provided to franchisor **Famous Dave's of America** to acquire seven restaurants from franchisee North Country BBQ. Famous Dave's is a national franchisor of barbeque restaurants with 177 locations in 38 states.

Wells Fargo Restaurant Finance provides capital to corporate restaurant brands, multi-unit restaurant franchisees, private equity firms and other financial investors in restaurant concepts. For more information, contact **Nick Cole**, executive vice president, at (760) 918-2705, or by e-mail at james.n.cole@wellsfargo.com.

GE Provides Growth Financing to Taco Bill, Inc.

GE Capital, Franchise Finance recently provided a multi-million dollar credit facility to **Taco Bill, Inc.**, whose owners, William Mullin and Christopher Walsh, operate multiple Taco Bell franchise units in California and Maryland. The loan helps Taco Bill acquire seven new units throughout the Baltimore area. Funding was provided through GE Capital, Franchise Finance's bank affiliate, GE Capital Financial, Inc.

Taco Bill, based in Auburn, California, currently owns and operates 23 Taco Bell units, including the new acquisitions from this funding. Its affiliate company, Cross Country Ventures, owns 18 Long John Silver's in Pennsylvania.

GE Capital, Franchise Finance is a leading lender for the franchise finance market via direct sales and portfolio acquisition. More information is available by calling 866-GET-GEFF (438-4333).

FINANCE SOURCES

Direct Capital Increases Lending Capacity for Franchisees; Adds Programs

Direct Capital, a national direct lender to the franchise sector for nearly 20 years, announced it will increase its funding commitment to the franchise industry by about 50 percent. This expansion is supported by their direct lending facilities in excess of \$250,000,000. Direct Capital is focused on working with franchisees and franchisors to create programs that get needed funding flowing from Wall Street to Main Street, to help alleviate the credit crunch experienced by franchisees.

The company provides financing for equipment, soft costs and working capital to franchisees in the form of leases, commercial loans and business cash advances. Their programs cover new store development, remodels, relocations, expansion projects and more. Deal size can be as low as \$5,000 on up to \$500,000. However, they first partner with the franchisor to understand the concept and the capital needs of the system. This understanding allows them to provide the widest lending window to accommodate the needs of the brand.

“Our underwriters evaluate personal and business credit almost equally to the strength of the franchise concept,” said **Paul Ringuette**, Vice President of Franchise Funding with Direct Capital. “How a franchisor manages their concept is an important determinant to risk, how they recruit, their fee schedules and royalties. It’s also about risk,” he says, “for some franchisors that actively engage with lenders to assist with mitigating that risk, there are expanded lending capabilities and reduced rate structures.” He adds, “We want to work hand in hand with the franchisor. In the case of a store going dark, knowing they will help get a new operator in there to pay the bills and keep the lights on, is important.”

Direct Capital is looking to work with franchisors with more than 200 locations and more than 10 years in business. They have a sizeable portfolio of QSR concepts and “several thousand franchisees on our books,” said Ringuette. They’ve provided capital to franchisees of Burger King, Dunkin’ Brands, Yum! Brands and Subway, to name a few. “Consistency and predictability are key to these relationships,” added Ringuette. We engage with the franchisor to set expectations on how we are going to work with their franchisees and how their three- to five-year loan process will be managed.”

Direct Capital’s lending expansion has come just in time for many franchisees, says **Robyn Gault**, Director of Strategic Accounts with Direct Capital. “Banks have pulled in from the window that we’re playing in. Franchisees who previously relied on their banking relationships have seen credit lines reduced. We are finding that more and more franchisees are hitting exposure limitations with their existing lending relationships.”

For franchisees, “our goal is to be with them for the total lifecycle of the store, covering new store development, required remodels and standard upgrades,” she said. Headquartered in Portsmouth, New Hampshire, Direct Capital employs 223 people who work on origination to servicing through the end of the finance term.

In addition to increasing their loan volume this year, they have added new programs that are designed to help franchisees meet their development goals with limited impact to cash flow. For example, Direct Capital has a new program which allows franchisees to reduce payments during specific months to stabilize cash flow during their slower season. They’ve also created pre-approved working capital lines for a large number of franchise concepts to support the daily needs of the business (advertising, payroll, taxes, etc) that can be accessed rapidly with limited paperwork.

“Times are tough on everyone right now,” said Ringuette, “and franchisees are no different.” And, Direct Capital is focusing on solutions that help them through these tough times. For more information on in Direct Capital, contact Paul Ringuette, (603) 373-1342, or by e-mail at pringuette@directcapital.com, or Robyn Gault at (603) 433-9476 or by e-mail at rgault@directcapital.com.

Eagle National Bank Becomes SBA Preferred Lender with Franchise Focus

Eagle National Bank announced that it has been designated a Preferred Lender in the U.S. Small Business Administration (SBA) Preferred Lender Program (PLP). With PLP status, Eagle’s newly formed SBA Finance Group will have discretionary authority to issue the loan guaranty agreement and other loan approvals necessary to permit a small business to receive an SBA guaranteed loan. Eagle will offer 7(a), 504 and USDA Business and Industry loans to their customers.

Rocco Perate has been selected as the President/COO of the new SBA Finance Group, which has approved over \$8 million of loans so far, with more than \$30 million projected for the year. Perate indicated that the group will primarily focus on all SBA-eligible industry categories.

Perate added, “Based on my extensive experience and knowledge in franchise and restaurant finance, we will also make this industry segment a special focus of our lending activity and have already funded and/or approved several franchise and restaurant transactions. At this point, we are lending within our footprint (the states of PA, NJ, DE and MD) but plan to expand that footprint in the third quarter of 2010.”

They will focus on most of the major brands (fast food and casual dining) as well as independents.

Eagle National Bank, the principal subsidiary of Eagle National Bancorp, Inc, is a community bank that presently operates five full service banking branches in Delaware, Chester and Montgomery counties of Pennsylvania. Its mortgage banking division operates approximately 100 loan origination offices in 36 states around the country. For more information, contact Rocco Perate at 484-455-2853 (office), 610-547-2945 (mobile) or by e-mail at rocco.perate@eaglenational.com.

Troff Joins Caledonian Private Equity Partners

Bill Troff has joined **Caledonian Private Equity Partners** as managing director of their newly formed restaurant corporate finance and mergers & acquisitions advisory practice. Troff has 35 years of experience in the restaurant industry, and most previously spent five years as director of business development with Mastodon Ventures, an M&A advisory firm specializing in the restaurant industry. His division at Caledonian will concentrate on mergers and acquisitions and corporate finance, including bridge loans, lines of credit and senior debt facilities.

“My function is really sell-side assignments,” Troff said, and indicated they intend to target tier one QSR and casual dining brands.

For large national brands, he says, there is a significant pool of qualified management that would be good candidates for acquiring a multi-unit restaurant business. For management teams willing to put some skin in the game in an acquisition, it has to be “significant for those individuals,” he added, “but not to the total transaction.”

“If there is a Burger King guy with 25 years of management experience, and he can write a check for \$100,000 on a \$20 million deal, that gives investors a great deal of comfort,” he explained. “We can pair a strong management team with a strong investor so that investment and operational risk is mitigated.”

“There is a set group of buyers who like franchises. If you approach it the right way with strong management and financial backing, the franchisors will usually approve it, too.”

Troff says Caledonian’s banking, institutional investor and family office relationships have a willing pool of capital to support and back experienced management teams.

One of the goals is to bring out the true value of the restaurant concept for the seller, and package it so that investors can understand it. “We’re bringing bigger banking experience to these smaller transactions,” he said.

For those looking for acquisitions, “it is a great time,” he said. There are franchisees who are overleveraged, “and are tired of fighting for survival and they basically want to get out. This presents upside for those who want in.”

Troff is telling clients that investors need a certain threshold of return, and they have to leverage their equity into the total purchase price. “That purchase price is dictated on what their internal rate of return is,” he said. “It’s hard to overpay.”

And, he added, investors know that if they buy it at 5x today, “then it will look like 5x a couple of years from now. They are figuring out how quickly they can convert the debt equity if they are counting on 1 to 2 percent annual growth. They can’t count on three or four percent annual growth anymore. This is the new normal.”

But, the good news is there is an abundance of family office and private capital available, he said. “Senior and junior debt is available, but lenders are cautious. Transactions have to be sponsored by a solid management team with solid unit economics.”

For more information on Caledonian Private Equity Partners, contact Bill Troff, managing director, at (512) 258-3545, or by e-mail at bill.troff@caledonianprivateequity.com.

MCC Sees Major Lending Growth in the First Quarter

Mercantile Capital Corporation reports it closed on five commercial property loans worth more than \$11.6 million in total project costs in January. The firm, which ranks as one of the largest providers of U.S. Small Business Administration (SBA) 504 loans in the nation, predicts it will see a record first quarter this year with loans worth more than \$26 million in total project costs.

One of these was for the purchase and construction of a building for Osaka Japanese Steakhouse in Midland, Texas, which offers Japanese cuisine from sushi to Hibachi. The total project cost was \$2.076 million.

Mercantile should close on loans that represent more than \$103 million in total projects this year, said **Chris Hurn**, president and CEO.

Hurn added that the firm closed on only three commercial property loans during the first quarter of 2009. MCC finished the year with 35 closed loans worth over \$78.1 million in total project costs.

For more information on Mercantile Capital Corporation, contact Chris Hurn, president and CEO, at (407) 786-5040, or by e-mail at churn@mercantilecc.com.

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JACK IN THE BOX

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At their peak, Alizadeh's companies owned and operated 70 Jack in the Box restaurants, 11 T.G.I. Friday's and five Qdoba's. He was the second largest franchisee in the Jack in the Box system and the 42nd largest restaurant franchisee in the nation, according to the Monitor's ranking of the top 200 franchisees.

He was a leader in the Jack in the Box system, too. He helped form the Jack in the Box franchisee association and later began a purchasing co-op for storeowners. He was chairman of the co-op and co-chairman of the association at the time of his bankruptcy filing.

He was also often recognized as an outstanding operator. Jack in the Box named Alizadeh the franchisee of the year in 2006 and he won the Highest Food-Safety Performance Award in 2007. As recognition for his successful career, Alizadeh won a Lifetime Achievement Award at the franchise convention in 2007.

Up and down relationship

The relationship between Alizadeh and Jack in the Box, a predominantly company-owned system, wasn't always friendly. After the E. coli contamination, in which four young children died and hundreds were sickened eating tainted Jack in the Box beef in 1993, Alizadeh and other franchisees took a militant tone with the franchisor about operations and purchasing.

The franchisees and Alizadeh formalized an ad hoc group of franchisees into the National Association of Jack in the Box Franchisees shortly after the E. coli incident and sued Jack in the Box for damages. They settled the lawsuit for \$44 million.

As president of the association, Alizadeh's tactics often ruffled feathers at Jack in the Box. In 1996, the association sued Jack in the Box again to "open its books" and account for \$15 million in payments from Coca-Cola and other suppliers. The franchisees wanted an accounting of the rebates, and believed they were being used by the company for its own marketing and overhead. They wanted the rebates to go directly to the franchisees as they do in many other systems. This second lawsuit created long-lasting, bad blood between the company and the franchisees.

"It wasn't personal. We needed to improve our margins to survive," said Alizadeh.

Jack in the Box instead won the lawsuit, citing the terms of the franchise agreement as the document that allowed them to keep the rebates. This further alienated Alizadeh and most of the franchisees who followed him.

The new franchisee association then formed its own cooperative to control their purchasing activities. The association held its annual meetings in Hawaii, away from Jack's corporate headquarters in San Diego. Corporate executives were invited to attend one such meeting in 2001, but declined. The franchisee meeting deteriorated into the negative aspects of the

franchise relationship and some franchisees openly discussed the possibility of suing Jack in the Box again.

The relationship was at its lowest point in 2001 and Alizadeh took much of Jack in the Box's ire as the point person for the association. "Abe Alizadeh was well-meaning, and genuinely interested in the success of his fellow franchisees," said Andy Selden, attorney for the association.

Franchisees' fortunes improved after the economy emerged from the post-9/11 recession and, not surprisingly, so did their relationship with Jack in the Box executives. Jack in the Box's new franchise sales and development leader, John Ramsay, has an easy-going nature and was ultimately responsible for bringing both sides together for discussions again. The company began to attend association meetings and the relationship started to improve.

Alizadeh told an audience at the Restaurant Finance & Development Conference in 2003 that the relationship between Jack in the Box and the franchisees was greatly improving. And he also began taking advantage of the chain's refranchising effort and bought up corporate stores, more than doubling his holdings between 2003 and 2007.

But Alizadeh's view of the new, positive relationship wasn't universally shared by all at Jack in the Box. "There were some who would never forget the lawsuit," said Ramsay.

A building binge

Alizadeh was also making a name for himself in the Sacramento area as an aggressive real estate developer. He and Kobra bought up numerous parcels in northern California, Oregon and Indiana for office and retail developments. The two created a vertically integrated company, using numerous subsidiaries to control everything from design and planning to construction and maintenance.

They built strip malls, hotels, apartment buildings, offices and condos. Alizadeh planned even bigger projects like a conference center and outlet mall. He also bought a pair of sports teams, the minor league baseball team Portland Beavers and the U.S. Soccer League's Portland Timbers. He openly talked to reporters of bringing another major league sports franchise to Sacramento. Business magazines hailed him as one of the most powerful and influential businessmen in northern California.

According to the bankruptcy filings, Alizadeh's real estate development companies owned at least 80 properties and nearly 1.9 million square feet of buildings with another 550,000 square feet under construction—though reports of Alizadeh's holdings vary. In presentations to developers, according to legal filings, Alizadeh insisted that he owned more than 120 properties worth more than \$1.28 billion.

Alizadeh's rapid growth into real estate and other businesses elicited two types of responses from those at Jack in the Box. Some saw Alizadeh's growing net worth and size as a threat to the company, while others questioned how Alizadeh could

borrow so much money. “There were also worries inside the company that Alizadeh was spending more time on his outside business interests than he was on Jack in the Box business,” said Ramsay.

A shaky foundation

A rapidly slowing economy and the vast size of Alizadeh’s real estate empire was more of a concern. The Alizadehs bought much of the land at the height of the market, and developed its projects mostly with easy debt—provided by lenders who saw the increasing values of Alizadeh’s holdings as ample security.

But that speed proved to be problematic. New developments were often started before the old ones were fully leased, and didn’t generate the expected income. The economic decline only made matters worse. Office and retail space was increasingly difficult to fill, especially in Northern California. Vacancies became common. Alizadeh said in legal filings that he lost 400,000 square feet of tenant space with retail bankruptcies such as Circuit City, while other tenants fell behind on their lease payments.

By late 2007, Alizadeh’s real estate issues had become a huge problem. Construction companies and their subcontractors filed liens by the dozens that year. Lawsuits followed the next year, and lenders joined the legal fray.

So did investors. Hossain Dezhm sued Abe and Kobra Alizadeh for fraud, claiming he lost \$3 million on a deal. Dezhm said he made a short-term loan to Alizadeh that was supposed to help secure a \$100 million loan from Wells Fargo. The funds were to be repaid in 60 days, with interest, but that didn’t happen. “It just got eaten up immediately,” said Dezhm’s attorney, Paul Cass. Properties used as collateral on the \$3 million—which Dezhm didn’t investigate before making the loan—turned out to be worth less than their mortgages.

The real estate bankruptcy

Amid lawsuits and foreclosure filings, Alizadeh placed his real estate company into bankruptcy in November 2008. At least a dozen projects were stopped midstream with little more than construction skeletons in the ground. Equipment, much of it rented, was left abandoned.

Alizadeh’s real estate company was \$390 million in debt, an amount that stunned observers. The properties listed value of more than \$500 million turned out to be far from reality due to the slumping economy. Six of the properties, five of them Jack in the Box restaurants, were sold at a bankruptcy auction in January. The rest of the properties were not worth the amount of debt and liens tied to them and are reverting back to Alizadeh’s lenders.

“Every one has different liens and a different amount of debt,” said Don Fitzgerald, attorney for Steven Victor, the trustee overseeing the property case. “No two are the same.” Victor described the case as complex, but that is “not uncommon in real estate cases today.”

Nevertheless, Victor has sued Abe and Kobra Alizadeh over a laundry list of allegations, including “gross mismanagement, negligence and intentional misconduct.” The trustee charges that the company made a \$5.4 million personal loan to Abe Alizadeh that was never returned. And Victor charges that the owners failed to adequately capitalize the company and should pay \$9 million each to make up the difference between what is owed unsecured creditors and what will be available to them from the sale of assets.

Affecting the restaurants

Alizadeh’s restaurants might have been safe from the debt-fueled fire engulfing his real estate holdings. They were profitable restaurants—the 70 Jack in the Boxes generated \$92.5 million in revenue in 2008 and \$5.7 million in net income, according to Alizadeh’s bankruptcy testimony. Yet Alizadeh had been using the restaurants’ income to keep afloat his sinking real estate business. And sales were now declining at Alizadeh’s Jack in the Box and TGI Friday’s restaurants.

It’s uncertain exactly how much money was transferred from the restaurant companies to the real estate company. Janice Merrick, a workout specialist who examined the restaurants’ finances for the National Bank of Arizona, one of Alizadeh’s largest creditors, said in a court filing that she estimated the amount to be \$10 million. Beverly McFarland, later appointed trustee over the restaurants, said that the figure, while still being determined, “is a lot more than \$10 million.”

What is clear is that these payments often took precedence over other bills, according to McFarland. National Bank of Arizona declared Alizadeh to be in default in October 2008, a month before his real estate company went into bankruptcy. The bank sued in December that year to place the restaurants into receivership, but the sides reached a forbearance agreement. The bank sued again in July 2009 claiming Alizadeh breached that agreement.

Merrick, in her review for the bank, described a company operating in crisis management mode, where “whatever appears to be the crisis at the moment is what gets paid rather than carefully measuring and managing cash flow.” For instance, Merrick said that individual stores frequently paid utility bills with cash to keep the lights on.

The situation gets worse

A hearing on the receivership case was set for September, but it would never take place. On September 16, the California Board of Equalization revoked Alizadeh’s provisional license to operate Jack in the Box restaurants for failure to pay sales taxes. The stores were shut down the next day, and a Chapter 11 bankruptcy was filed on Friday, September 18, enabling them to open again. About \$16 million in sales and payroll taxes were owed at the time, according to the trustee’s accountant, Michael Gabrielson.

That same day, Alizadeh lost his T.G.I. Friday’s—the franchisor ordered Alizadeh to shut down those restaurants due to unpaid royalties. A judge ruled in Friday’s favor.

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In an affidavit filed with the bankruptcy court, Alizadeh himself acknowledges the problems associated with the transfers. He said the franchises made \$18.5 million in three years, but “a sizeable portion of the (Jack in the Box) Debtors’ income has been used in recent years to subsidize operating losses in certain real estate ventures ...” He said the use of funds left the restaurants “with insufficient cash flow and delinquencies owing to its own creditors.”

The negative publicity over the temporary store closings was devastating to Alizadeh and embarrassing for Jack in the Box. The company had previously told the Monitor that Alizadeh’s problems were unrelated to his restaurant operations. And Alizadeh still felt he could reorganize the restaurants in bankruptcy and solve his financial problems.

He certainly didn’t expect he would lose control of the restaurants. Despite the financial and tax issues, it’s rare that a trustee is appointed to oversee a bankruptcy in a franchise case. Yet that is exactly what happened. On the Tuesday morning following the restaurant bankruptcy filing, Judge Christopher Klein—the same judge who was overseeing Alizadeh’s real estate bankruptcy—ruled that a trustee should be appointed to run the restaurants. Most of the creditors agreed, citing the inter-company transfers and unpaid taxes.

“This is a case that screams for a trustee,” John Clemency, attorney for the National Bank of Arizona, said in a court hearing.

That task would ultimately fall to McFarland, an experienced real estate and business expert whose company, The Beverly Group, has provided Chapter 11 trustee services for 27 years. McFarland’s grandmotherly manner masks a penchant for bluntness and a willingness to play “hardball” when it is warranted.

Nowhere is this more evident than in her descriptions of the problems she encountered upon taking over the Jack in the Box stores. She said that hundreds of payroll checks had bounced—something Merrick also encountered in her review, when she noted that one manager opted to take money out of the cash register to replace his check. “When you walk in the door and find several hundred payroll checks that bounced, there is an issue here,” McFarland said.

There were other problems, too. According to McFarland, store maintenance had been delayed, though Alizadeh says the properties were in good condition. Financial records were commingled with the real estate entity and other entities, and she found Jack and the Box staffers performing tasks for the property side.

McFarland felt that Alizadeh had focused too much of his efforts on keeping the real estate business afloat, to the detriment of the restaurants. “He was cutting corners in order to keep money going to the real estate operation,” McFarland said.

Complicating issues for McFarland was a steep drop in sales at Alizadeh’s and other Jack in the Box restaurants, due largely to high unemployment rates in California among their main demographic segment: 18 to 30 year olds. Jack’s first-quarter same-store sales fell 11.1 percent. Alizadeh’s restaurants fell more than 15 percent, according to McFarland, which was not unusual for California franchisees in the chain.

Trying to Maintain Control

Shortly after McFarland was appointed trustee over the restaurants, Alizadeh sent a letter urging her to give him operational control for 90 days under her oversight. “No one has greater motivation to turn this situation around than I do,” he wrote. “My life’s work, my pride and my reputation are all riding on successfully bringing my 70 restaurants out of bankruptcy.”

McFarland denied the request. “After I reviewed the records, I didn’t feel it appropriate for him to be in control in any capacity,” she said. Alizadeh argued against the appointment of a trustee in his own bankruptcy case. “I should have been given an opportunity to reorganize my own company. The franchise agreements were all in my name,” he said.

McFarland disagreed. “Once the judge loses confidence in a particular person, it is his prerogative to appoint a trustee.”

Alizadeh then turned to Jack in the Box for help. He tried to arrange a meeting with Jack in the Box’s CEO Linda Lang and vice president of operations, Lenny Comma. But Alizadeh claims they never called him back.

In January, Jack in the Box vice president of franchising, Michael Bamrick, e-mailed Jack in the Box franchise operators, telling them that as long as a trustee is in charge of the operations that Alizadeh “can neither attend (a franchisee business) meeting nor receive reports of what occurs there.”

In response, Alizadeh wrote a letter to Lang, Comma and Bamrick in late January, apologizing for the negative publicity to Jack in the Box over his financial difficulties and the temporary closing of the restaurants. He also complained about his treatment by Jack in the Box and their refusal to meet with him.

“I still do not understand your position with regards to my bankruptcy,” he wrote. “Both the judge and the trustee acknowledged that a reorganization plan is the first remedial step in a Chapter 11, not an auction. It is completely proper, appropriate and within the law for me to meet with the trustee, the taxing authorities, my suppliers, my secured and unsecured creditors and my franchisor to try and work out an acceptable reorganization of my companies. All of them agreed to meet with me, except for you.”

Some franchisees, citing Alizadeh’s work with the association and the co-op, urged Jack in the Box to support him. Michael Bladow, CEO of Emerald Cascade Restaurant Systems, a multi-unit franchisee of Jack in the Box and Qdoba, wrote to Lang and Comma, saying that Alizadeh was in need of help and support.

“Abe is recognized across our community and within our industry as a unique individual, who is one of Jack’s best ambassadors for the brand. He is an asset whose value we all need to recognize,” said Bladow. He added that Abe should be assisted in “rejoining the Jack in the Box family.”

Trustee McFarland defends Jack in the Box’s disassociation with Alizadeh. “He was in default with Jack in the Box on multiple grounds and the trustee had become the court-ordered franchisee,” she said.

Yet Alizadeh told the Monitor that he was only 30 days delinquent with Jack in the Box on rent at the time of the filing, was personally liable on all of the franchise agreements and had requested meetings for months with Jack personnel only to be ignored. “I called them and left this message: Please let me tell you how I can reorganize. No communication from them,” said Alizadeh.

According to an affidavit filed with the court by Jack in the Box, rent wasn’t the only problem. Alizadeh was nearly \$2 million behind on royalties, marketing and other payments. Alizadeh claims that Jack in the Box owed him almost \$600,000 for remodeling credits and that in the context of his monthly sales, the arrearage wasn’t that high.

Alizadeh claimed that certain Jack in the Box executives could never get over the franchisee association’s lawsuit and that they used this as an opportunity to get him out of the system by ignoring his pleas for help. “I paid them over \$360 million as a franchisee. They were one of the smallest creditors, yet they were the most vicious. They did not afford me the opportunity to reorganize. Who would of thought my franchisor would become my worst enemy,” said Alizadeh.

Phone calls and e-mails to Jack in the Box officials for comment were not returned, and a company spokesman would not comment for this article.

Tim Duggan, a bankruptcy attorney with Stark & Stark in New Jersey, said that it’s typical for the franchisor to deal only with the trustee in a franchisee bankruptcy case. “If I was the franchisor, I’d deal with the trustee, also,” he said.

An auction of the restaurants

By early February of this year, McFarland and the creditors had determined that the restaurants were too much in debt to reorganize and that the recent sales declines were lowering the ultimate value to the estate. The restaurants had roughly \$40 million in secured debt and another \$40 million in liabilities according to McFarland’s calculations and were losing \$1 million in value per month.

McFarland had closed three restaurants, and Jack in the Box cancelled the lease on another—one of Alizadeh’s most profitable units. McFarland contracted with National Franchise Sales, based in Irvine, California, to conduct an auction for the remaining units.

But first, National Franchise Sales had to go about the process of marketing the restaurants, qualifying bidders with Jack in the Box and the court and establishing a “stalking horse” bidder.

National Franchise Sales established three stalking horse bids—a group led by existing franchisee Anil Yadav for the Sacramento area, a group led by existing franchisee Ben Nematzadeh for the Fresno area, and a group led by new franchisee Romesh Japra for Eureka and Crescent City. The three bidders produced combined bids totaling \$27 million.

Alizadeh began mobilizing a bid for the upcoming “overbid” auction which would be held on February 23 and 24 in Sacramento. The company that would bid was called Silver Leaf, Inc. and would be run by Shari Karig, Alizadeh’s wife and a former Jack in the Box corporate employee, and Parham Alizadeh, Abe’s nephew. Both Mitra and Azita Alizadeh were listed as investors, along with Austin Wallestad, former vice president of two of Alizadeh’s Jack in the Box holding companies. Abe Alizadeh was listed as a “consultant.”

Jack in the Box immediately objected to Silver Leaf’s bidding in court documents because of the investors’ connection with Abe Alizadeh and previous management. The company called Silver Leaf “merely a continuation of the Debtor in another guise.” It claimed that Alizadeh would be in position to exert considerable influence on the new company, both through his own guarantee of the debt on the proposed purchase and through family members.

“Jack in the Box’s management devoted countless hours of time to addressing and trying to manage the numerous issues created by the Debtor’s financial situation and its resulting effects,” Jack in the Box said of Alizadeh in the filing. “This became a constant drain on the time and resources of the senior management team. While under the management and control of Mr. Alizadeh, Jack in the Box’s brand suffered repeated and continual damage due to Mr. Alizadeh’s actions over at least a two-year period.”

Jack in the Box cited many of the problems noted in this story, plus food safety concerns due to “improper distribution.” “Jack in the Box has already suffered through more than 18 months of pre-petition payment defaults, non-monetary defaults, food safety issues and the closing of the Debtor’s restaurants, all of which resulted from the management of Abe Alizadeh, the former sole shareholder and chief executive officer.”

In a declaration filed with the court, Parham Alizadeh, Alizadeh’s nephew, quoted Peter Duncan, outside counsel for Jack in the Box, as saying that Silver Leaf’s application would be denied by the company even if Silver Leaf had \$1 billion.

The trustee’s attorney David Honig said he knew Abe Alizadeh would get nowhere with Jack in the Box. “There was no way that Alizadeh would ever be allowed to bid on these restaurants,” Honig said.

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In documents filed with the court, McFarland stated that Silver Leaf had not filed its bidding qualification documents on time, had never furnished a qualifying deposit, had not adequately shown it holds cash equity or financing for the transaction and had not obtained Jack in the Box's pre-approval to become a franchisee. Judge Klein ruled in the trustee's favor and Alizadeh was not allowed to become a bidder at the auction.

'As if our children were auctioned off'

On the night of the opening day of auction, Alizadeh, his sisters and a few friends gathered somberly in his Roseville, California office conference room shaking their heads at the turn of events earlier that day. "This was a sad day for our family and our employees," Abe Alizadeh said. "It was as if our children were auctioned off."

Alizadeh talked of bypassing the bidding process and making a bid for the restaurants directly to the court despite the tremendous odds against him. He said that he was also thinking of making a comeback with another franchise system.

No matter what, however, the topic of the conversation that evening kept coming back to Jack in the Box, and his view of the company's treatment of him in his time of need. This final act was, in Alizadeh's view, a way for Jack in the Box to get even with him. "This is payback," he said. "If you want to challenge us, we will get you. This is payback for what happened 20 years ago."

Kenn Schmitt, a former Jack in the Box employee from 1973 to 1985 and a franchisee from 1985 to 2006, and now a consultant to Alizadeh, thinks Jack in the Box was simply overwhelmed by the bad publicity related to Alizadeh's problems, especially in light of their plan to rebrand much of their company stores.

"The last 18 months have created too many problems for Jack in the Box," Schmitt said. "They like to be in control of things and they're just not equipped to deal with franchisee problems."

Auction participants had mainly positive feelings for Alizadeh, but some thought he got too big, too fast. Most recognized the contributions he made to the Jack in the Box system over the years. But others felt he was solely responsible for his own problems because of all of the outside interests and his reliance on debt.

"I feel sad for Abe because he did so much for the Jack in the Box system," said Millie Vang, a franchisee. "But, he took on too much debt."

One franchisee said he was glad to see Alizadeh go. In an e-mail to other franchisees obtained by the Monitor, franchisee Terry Herrick said that Abe's "approach to business was the cause of financial damage both inside Jack in the Box and definitely outside our brand."

In the end, Alizadeh's bankruptcy and the subsequent auction of his restaurants proved there was still interest in franchised Jack in the Box restaurants, at least in California. The interest manifested itself during the auction when more than 120 bidders were prequalified and as many as 45 showed up in Sacramento at the overbid auction for the stores. This interest came, despite the chain's recent sales performance and the poor California economy.

For all his problems, Alizadeh himself remains optimistic. And he looks forward to the future, perhaps with another restaurant chain. "Mistakes were made, undoubtedly. I can take and learn from this. You apologize to those you hurt. You believe in yourself and you go on. There will be some fantastic possibilities in the future."

Despite Alizadeh's own admission of taking on too much debt, the management mistakes, the temporary store closings and the issues related to his other companies, there is a sense here that Jack in the Box should have done more for him in his time of need, even if it was just to support him to reorganize his restaurant company.

Greg Gribble, a franchisee in the Los Angeles area, says "he will miss Abe because he was a great mentor to me and other franchisees." Brian Emry, a franchisee in Sacramento sums up the feeling of many of the franchisees he spoke to. "Yes, Abe created problems for himself, but he was a tireless advocate for the franchisees and the brand. I think the company treated him badly," said Emry.

Final drama plays out

On March 17, a bankruptcy hearing took place in Sacramento to ratify the sale of the 66 restaurants to the winning auction bidders.

Mitra Alizadeh came to court and through her attorney submitted a bid on behalf of she and her sisters, Azita and Parvaneh, to acquire 64 of the restaurants for \$42 million. Their attorney stated that the trio had received a bonafide financing commitment from a large investment fund and that they were prepared to run the restaurants.

Judge Klein asked a number of questions about the financing commitment and whether the group was approved as a Jack in the Box operator to run the restaurants. The judge told the trustee, Beverly McFarland, to work with the Alizadehs and try to qualify them as a back-up bidder.

McFarland said she was interested in the Alizadeh's bid, but said that the group still must meet a number of conditions to be qualified as a backup bidder, including receiving the approval of Jack in the Box. "They could also potentially be invalidated if Abe Alizadeh is found to be involved in the buying group. It would not be in their best interest to have him involved," said McFarland.

The judge later approved the sale of the 66 restaurants to the winning bidders for \$39 million.

Jonathan Maze and John Hamburger

Inside the Jack in the Box Auction

Jack in the Box may be struggling with declining sales and Abe Alizadeh's restaurants may be in bankruptcy, but that didn't stop franchisees and others from aggressively bidding for his restaurants.

Once the decision was made by Beverly McFarland to auction the restaurant business, she contacted National Franchise Sales. McFarland had worked previously with them in the sale of 26 Taco Bell restaurants a few years earlier and felt she got a good result.

Once approved by the court, National Franchise Sale's CEO Jerry Thissen put together an auction team made up of restaurant industry veterans Alan Gallup, Michael Ingram, Michael Arrowsmith, Helen Trent and John Lukac. The team marketed the restaurants to clients and the restaurant trade by way of advertisements and e-mails. Approximately 123 qualified groups signed confidentiality agreements to review the detailed financial package (there was no real estate involved in the deal) and took the necessary financial and franchise steps to qualify as bidders.

According to Gallup, the bidders consisted of "a blend of financial and strategic buyers including both single unit buyers and entities capable of acquiring the entire group."

The first step in the auction process was to accept preliminary bids to identify the highest initial bid, also known as a "stalking horse bid." A group led by Anil Yadav, a franchisee of Jack in the Box with over 120 units, offered to purchase 38 store locations. Ben Nematzadeh, a franchisee in Southern California offered to purchase 21 store locations, and a prospective franchisee, Romesh Japra, offered to purchase 2 store locations. Five stores were not included in any of the stalking horse bids. The total stalking horse bid in this case totaled \$27 million.

The second phase of the auction process was the "overbid" live auction, which took place in Sacramento on February 23 and 24. Approximately 45 pre-approved bidders showed up at the Citizens Hotel in Sacramento on those dates for the live auction. The bidders could submit bids above the stalking horse bids, or in any combination.

Certain bidders were limited as to their financial wherewithal, pre-approval by NFS or their pre-approval by Jack in the Box. After the first day of bidding, the value of the stores had increased to \$32 million. There was active bidding.

According to Thissen, the combinations of bids involved in the auction were approximately 6 million different options. This was because bidders could submit multiple bids, even with contingencies such as not getting one store or another. The only way National Franchise Sales could keep track of all the bids and bid combinations was because of a proprietary auction program they recently developed.

On the second day of bidding, the rules tightened for bidders. Bids had to be submitted in a way that the estate would benefit, and unusual carve outs and contingencies were prohibited. "On the first day you had the smaller bidders trying to cherry pick certain stores, but once the numbers got up there, the big guns came out," said Thissen.

Bidding became more aggressive that afternoon, back and forth between Yadav and Nematzadeh, so that at one point National Franchise Sales made the decision to raise the minimum incremental bid amount to \$200,000. The most spirited bidding action was for the Sacramento locations, and Yadav and Nematzadeh began forming coalitions and discussing potential store trades with some of the other bidders. Finally, Yadav outbid Nematzadeh on Sacramento and Nematzadeh outbid Yadav on Fresno and Chico.

Once the bidding ended, the final numbers ran up to \$39 million. Yadav ended up with the 31 Sacramento restaurants for \$18 million. Nematzadeh agreed to pay \$19.9 million for 31 restaurants around Fresno and Chico, CA. Two other bidders lined up the remaining four stores for \$1,100,000.

The average price of the auctioned restaurants was approximately \$591,000, about the same as Jack in the Box has been getting in their recent refranchising efforts.

Some Jack in the Box franchisees intimated that Yadav and Nematzadeh got too caught up in the bidding war and paid too much. An estimate of the store valuation based on EBITDA is difficult to determine because of the big decline in Jack in the Box sales over the past year. Based on store-level EBITDA from 2008, the multiple using a \$39 million price tag was under four times cash flow. But EBITDA was going down due to declining sales, so we estimate the multiple in the end to be approximately five times EBITDA. If Yadav and Nematzadeh can improve on the results and get the cash flows back to 2008 levels, they got a good deal at that price.

The trustee, Beverly McFarland, was ecstatic over the success of the auction and the performance of National Franchise Sales. The preliminary stalking horse bid had increased by \$12 million and the buyers ended up being the same parties. Jack in the Box was probably happy, as well, with the drama almost over, and experienced franchisees at the helm of Alizadeh's stores.

"National Franchise Sales did an outstanding job managing this complicated process. I have nothing but the utmost respect for their team of professionals," said McFarland.

For more information about National Franchise Sales, contact Jerry Thissen, CEO, at (949) 428-0480 ext. 101.

ANALYST REPORTS

Red Robin Gourmet Burgers
RRGB-NASDAQ
(Strong Buy)
Recent Price: \$25.49



Red Robin Gourmet Burgers owns, operates and franchises more than 400 casual-dining restaurants that serve a wide selection of burgers, including beef, chicken, fish and turkey, salads, and appetizers. The concept has a below-average guest check, but caters to a more affluent demographic.

Raymond James analyst **Bryan Elliott** upgraded **Red Robin Gourmet Burgers** to “strong buy,” believing that the stock has the potential for “a sustained period of strong performance.” The company has seen a substantial sales lift from its television advertising, increasing the possibility for improved comp sales this year. The company began a limited-time offer promotion on February 22 in its markets, supported by national cable TV. The promotion will run for several weeks, and management forecasted a strong comp improvement in the first quarter, assuming that the sales gains are similar to those done during a limited offer last fall. Given that management remains confident in its forecast, “it appears traffic and sales mix results for the current promotion are meeting plan.” The company plans to run similar LTOs supported by TV ads in the summer and then in the fall, with total spending at \$16 million to \$17 million for the year. Red Robin is also looking for a new CEO, and Elliott believes the company could attract top talent.

McCormick & Schmick's
Seafood Restaurants
MSSR-NASDAQ
(Overweight)
Recent Price: \$9.60



McCormick and Schmick's Seafood Restaurants operates upscale dining seafood restaurants in the U.S. and Canada. Founded in 1972, the Oregon-based company operates 94 restaurants, 88 of which are in the U.S. and six in Canada under The Boathouse brand.

Nicole Miller Regan, analyst with **Piper Jaffray**, sees “at least 30 percent upside potential” in **McCormick & Schmick's** stock price and thus continues to recommend the company's shares. She also notes that corporate travel data has improved for the sixth consecutive month. RevPAR at luxury hotels have improved sequentially over the past six months. A third of McCormick's sales are attributed to corporate card transactions, and the chain's same-store sales have stabilized. Bad weather in the winter hurt sales, but “we firmly believe improving (less negative) traffic trumps any weather impact.” Comps have improved sequentially, from down 13.9 percent in October to down 10.8 percent in December. The chain also has a comprehensive recovery plan, ranging from menu changes to restaurant design. The balance sheet remains positive, “allowing for market share taking opportunities, eventually through new growth.”

Burger King
BKC-NYSE
(Market Perform)
Recent Price: \$19.47



Burger King Corporation owns and franchises fast-food hamburger restaurants in the U.S. and internationally. The system includes nearly 12,000 restaurants in 73 countries, 10,500 of them owned by franchisees. The Florida-based chain was founded in 1954.

Earlier this month, **Burger King** announced same-store sales for January and February 2010 as being down 8.2 percent. **Bernstein Research** analyst **Sara Senatore** noted that the results “compare unfavorably to MCD's flattish comps for the period but are roughly in line with CKE's monthly comps.” The sales decline, which compares with 3.1 percent growth in the same period a year ago, was blamed on bad weather along the east coast. Revenues, margin and operating income are also expected to be down for the quarter. BKC is reporting sales and traffic improvement thus far in March with better weather. The company expects comps to improve, and Senatore said, “the worst is likely behind the company, as leading indicators point to an improving consumer picture.” But she remains cautious on the stock as the release “could reinforce investor skepticism around management credibility.”

DEAL OPPORTUNITIES

Burger King Restaurants for Sale

Deal: Two well established high volume Burger King restaurants located in the upper Midwest.

Asking Price: \$1,550,000.

Deal Info: Desirable locations. Both restaurants have fully trained and have stable management teams in place. The land and buildings are also available separately. Sellers are retiring.

Broker: National Franchise Sales

Contact: For more information contact Mike Deegan at (949)-428-0492 or md@nationalfranchisesales.com.

Operating Houlihan's Restaurant For Sale in Cleveland, Ohio

Deal Info: An 8,000 square foot restaurant plus patio attached to a newly remodeled Fairfield Inn. It is located at Chagrin Blvd and Interstate 271. Join Flemings, Mitchell's Fish House, Hyde Park, Red, etcetera. Over 2,000 hotel rooms and over 3,000,000 sq. ft. of office space nearby.

Lease: \$110,000.00 per year with a 10 year lease.

Equipment: Negotiable

Broker: J.J.Herman & Associates, Inc.

Contact: Jerry Herman at (216)-642-3115 or cell (216)-219-2161 or jherman@jjherman.com.

Pizza Hut Operation Available For Acquisition

Deal: Ten-unit Pizza Hut operation available for acquisition in the southeast region of the United States.

Deal Info: Stores are in need of approximately \$1.5 million in reimagining. The package includes 4 Fee Simple properties. Financing is available for qualified buyers. Owner is pursuing other opportunities.

Broker: Advanced Restaurant Sales

Contact: Patrick Silvia at (678) 229-2384 Ext.1, or by e-mail at psilvia@arsales.biz

Acquisition Opportunity for Three Restaurants

Deal: Three top-tier franchised, casual dining/sports bar restaurants are available for acquisition.

Deal Info: Restaurants have strong cash flow and positive same store sales. Systemwide same-store sales are growing.

Broker: Franchise Capital Advisors

Contact: Ryan Kress at 480-355-4390, or by e-mail at rek@franchisecapitaladvisors.com

To List Your Restaurant Deal
Contact Mary Jo Larson
612-767-3200 or
mlarson@franchisetimes.com

Former Steak & Ale Available for Lease or Sale

Deal: The 5,560-square foot former Steak & Ale Restaurant is located on the southwest corner of I-20 and Little Road in South Arlington, Texas. The building is on 0.804 acres.

Asking Price: For sale, the asking price is \$1,226,610 "as-is". Leased price is \$20 + NNN's. Owners are negotiable.

Deal Info: The freestanding building has excellent visibility to Interstate 20 and a large pylon sign facing Interstate 20. The building is located within Lincoln Court shopping center, a 158,000-square foot retail center which is comprised of both national and regional tenants and anchored by one of the most successful LA Fitness clubs in DFW.

Broker: Venture Commercial Real Estate

Contact: For more information contact Amy Pjetrovic or Tonya Hagood at (214) 378-1212 at Venture Commercial Real Estate

ACCOUNTING STANDARDS

Change in Accounting Standards For Leasing Is Moving Along

Financial accounting standards have never been “simple” or “easy,” but the new proposed lease accounting standards could really take the complexity cake, at least if your restaurant rents its space or equipment, rather than owns it.

Proposed guidelines from the Financial Accounting Standards Board (FASB) would require the capitalization of all operating leases. The move could ultimately move billions of dollars in corporate leases to the balance sheet, not to mention generate billions of headaches among the nation’s accounting departments.

FASB is proposing the guidelines in response to criticism of its current system, which requires different standards for operating or capital leases. Capital leases are recognized on the balance sheet while operating leases are typically footnoted. The dual standards can generate confusion, and critics of the standards say it can be difficult to get a picture of a company’s leasing activity under the current guidelines.

David Tweedie, chairman of the International Accounting Standards Board, told Congress that the existing standards enable companies to hide their primary assets. An airline, for instance, may not have a single airplane on its books. “A balance sheet that presents an airline without any aircraft is clearly not a faithful representation of economic reality,” he said.

Or perhaps a restaurant may not have its actual restaurant building on its books, or perhaps its ovens or stoves or walk-in coolers. The SEC has estimated that public companies essentially hide \$1.25 trillion in future cash obligations this way.

Still, and perhaps not surprisingly, the FASB’s proposed fix has generated substantial criticism. “This could be very cumbersome,” said Paul Kinney, executive director of the National Retail Tenants Association. “The thing that worries our group, if you don’t have all of your records up to date, and all of your financial terms, you’re going to have to go in and get those for your financial people. They’re going to have to come up with the value of all of these.”

The good thing for restaurant companies is that they have time. FASB started its lease accounting project in 2006. The proposed guideline was released in a 109-page discussion paper a year ago and a draft could be ready by the middle of the year with a final rule due next year. After a transition period, it could be 2012 or 2013 before the new guidelines are required—but the SEC could delay it further, until 2015, Kinney said.

Judging from some concerns over the regulation, companies with a lot of operating leases could need those years. Once the rule is in place every lease will need to be recorded. “You’re going to have to look at every lease and rebook them,” said William Bosco, a consultant with the Equipment Lease and Finance Association. He was speaking during a National

Retail Tenants Association webinar on the topic that drew 200 people, twice the capacity of a typical association webinar.

Under the proposed lease accounting standard, companies will have to record the value of the right to use equipment or buildings as an asset, and the present value of the expected lease payments as a liability. This will increase the value of assets on a company’s books, potentially requiring them to hold onto additional capital.

Some say the new standards may be subjective. Kinney said that some believe tenant improvement dollars don’t have to be recorded, but others may think they do—that subjectivity could generate confusion.

One of the biggest concerns is the requirement that companies will have to estimate the length of time they expect to keep equipment or stay in their location.

For instance, if you have a 10-year lease with two, five-year options, Bosco said, you should estimate that lease as 20 years. But if that 10-year lease has a termination provision, then you have to decide whether you’re going to exercise that termination—if you do, then you recognize the lease as a shorter-term lease. And you have to record any potential termination penalties.

Another complexity: estimating rents. Companies may have to estimate how much they expect to pay on their lease in the coming years. “If someone has an option seven or eight years from now at fair market rent, how will they determine that?” Kinney said. “The best thing to say is that it’s going to be very difficult to do. The more time that lease administration and accounting people have to work on this, the better.”

Bosco called the proposal “job security for lease administrators.”

Experts suggest getting ready now by reviewing every lease you have and compiling all the information about the lease, including contingent rents, renewal and purchase options and residual guarantees. And companies will also have to begin thinking of their software programs, which will at least need to be updated, or replaced, when the new guidelines take hold.

“I’d be looking at your software system or talk to your vendor about how they’re addressing the changes,” Kinney said. “Nothing has happened yet, but are they thinking about it? If your system is internal, make sure your IT department is thinking about how they will implement the new changes. The biggest fear I would have as a lease administrator is to do nothing and wait for a decision, then find out we’re in trouble.”

— Jonathan Maze

Improved Financing Conditions

It's no secret that franchising has been impacted because of the financing problems that all small business owners are facing today. The number one complaint I hear from franchisors and franchisees alike is the availability of financing — "If only we could get money."

The money crunch is real and lenders, both banks and non-bank lenders, are scrutinizing operator balance sheets and recent operating performance like never before. The borrowers with collateral and cash flow eventually get financed and the ones that "have some hair" as they like to say, get rejected. Bankers just can't get their arms around "story" deals.

One thing to keep in mind is that the financing lollapalooza of 2002 to 2007 was an aberration. In 30 years of watching restaurant and franchise financing, there were always peaks and valleys in financing availability and lender aggressiveness, but the most recent period took the cake for lender rapaciousness. Restaurants and franchises experienced the same borrowing binge as housing, hotels, strip malls and office buildings. There was too much money chasing deals and we are unlikely to see that environment again in our lifetimes.

Despite the complaints of many prospective borrowers, I am seeing financing availability improving slowly on the national and regional level. The good news is that the major national restaurant lenders—GE Capital, Bank of America, Wells Fargo and First Financial (previously known as Irwin) are still in the game. They are announcing new lending deals again. There are other lenders like RBS Citizens Bank and Regions Bank that have introduced financing programs and are now extending credit. Other regional banks and specialty lenders are also examining the space and preparing to lend to this industry later this year.

SBA loan activity is also brisk. A year ago, the secondary market for SBA guaranteed loans was virtually shut down, but according to Ron Feldman of Siegel Capital, who spoke at our recent Franchise Finance & Development Conference "the secondary market for SBA loans is as strong as ever."

A strong secondary market for SBA loans is due to the increase in the amount of the SBA guaranty from 75% to 90% of the loan amount. Things should stay active in the short run as long as the 90% guaranty is in effect. In the long term, most lenders see the guaranty percentage changing back to the 75% level again.

The financing logjam is at the community bank level. Community banks have been moving away from conventional lending toward SBA guaranteed loans to take advantage of the government's 90% guaranty. The problem is that the maximum loan amount on an SBA 7(a) loan is \$2.0 million. Larger multi-unit franchisees don't qualify and must find financing in the conventional markets. There is talk of raising the minimum to \$5 million, but that is bogged down in Congress.

Community banks today are risk averse and moving their loan portfolio away from riskier deals, especially ones with

real estate. They are also lending only in their own trade areas and avoiding any deals outside of their "comfort zone." I have been advising franchisors to focus their franchising efforts on existing markets where community bankers can "touch and feel" the restaurant concept by visiting an open location and speaking with successful operators in the market. New markets are difficult to franchise right now, and finding financing for new market participants is even tougher unless the franchisee has lots of equity or can qualify for an SBA loan.

Don't hold your breath for community banks to rescue the industry. Community banks are focused on their defaults, credit downgrades, regulatory requirements and what to do with the real estate they've taken back in foreclosure. Things won't improve until the workouts are almost over so that lenders can focus again on new business. I see this lasting another two years or so.

One thing I've noticed in past credit upheavals is the emergence of entrepreneurial lending sources such as mezzanine lenders and leasing companies where they can command higher rates. The money carries higher rates—like 15-25% for hard-to-finance restaurant companies. Lenders like Capital Spring, which provides mezzanine financing to franchisees who are unable to fully fund their expansion, are busy right now. I'm seeing more groups forming to provide this type of lending.

On the sale-leaseback side, there hasn't been a lot of activity and larger deals are tough to complete. But smaller size deals can still get done. Cap rates have gone up and can range anywhere from 8-12% depending on credit. The 1031 exchange market, which absorbed many of these leasebacks, is a shadow of what it was three years ago. If you want to sell and leaseback a large number of properties, be prepared to do it in stages.

How is the credit crunch impacting new unit development and remodels? The hurdle rates for new development and chain remodels are higher now than they were in the past. With regard to remodeling programs, franchisees will be skeptical of the payback period, especially when they cannot finance a big portion of the improvements or new equipment. Franchisors need to fully test those remodels and be clear about the ROI before they order the franchisees to follow suit. Kerry Kramp, Sizzler's CEO, told attendees at our recent Franchise Finance & Development Conference that Sizzler was doing the remodels first in company stores, so they could accurately document the benefits for the franchisees.

Franchisors that want franchisees to develop must provide incentives to build new stores. Papa Johns is providing growing franchisees with a free pizza oven and no franchise fees. Sonic is offering a variety of incentives depending on the number of stores a franchisee builds, including no franchise fees or up to five years of royalty abatement. Franchisors such as Marco's Pizza have become directly involved in the financing process by providing credit enhancements.

John Hamburger

Theme At Bank of America/Merrill Lynch Conference Suggests Stabilizing Environment

At the recent Bank of America/Merrill Lynch Consumer Conference, some positive themes emerged about the state of the restaurant business. Analyst Joe Buckley summarized the event and the presentations by 12 public companies by saying that “restaurant sales trends remain challenging, with mostly negative year-over-year sales comparisons, but more companies are indicating that sales are showing some improvement. Additionally, the near-term cost outlook continues to look favorable and many companies are shifting to focus on returning cash to shareholders,” said Buckley.

While there were a few restaurant companies like Panera Bread and Chipotle (Panera was a presenter, Chipotle was not) that have defied the industry slowdown, most of the public companies sang the same story line. I have attempted to summarize these themes below:

Cost Cutting. Lower commodity costs, reduced portion size and general efficiency management has reduced the operating costs for many companies and allowed them to survive during the industry sales slump. While companies expect the commodity cost bonanza to end this year, most companies are confident of their ability to further reduce costs via stricter cost and portion controls, thereby insulating themselves from the compressed margins arising from discounting. When sales pick up, improved profits should be the result.

Rising Guest Satisfaction Scores. Maybe it is the discounting, or maybe restaurant managers have more time on their hands, but many of the presenting companies reported rising guest satisfaction scores. Maybe I just noticed it more at this conference. Companies generally don't announce lower guest satisfaction scores.

The 53/52 Accounting Period. Many restaurant companies that utilize a weekly 53/52 week accounting system benefited in 2009 from the 53rd week. It might be tougher to throw up those nice profit numbers in 2010 without that extra week of sales.

Unemployment. QSR chains like Jack in the Box and Sonic talked about the economic headwinds and the high unemployment rate affecting their businesses. Investing in QSR right now is really a bet the unemployment rate will be lower a year from now.

Development. Cheesecake Factory plans on building three units—its lowest unit output ever—this year on a base of approximately 160 Cheesecake Factories and Grand Lux Cafes. CEO David Overton blames it on the shutdown in the mall development world and the company's inability to assemble land needed to accommodate their large restaurant and parking needs. Unit growth was very light for most chains that presented.

Value Menu. Restaurant companies are trying to straddle a value menu approach while continuing to introduce premium products. On one hand, you invite in the cheapskates, and on the other hand you introduce a product that costs an arm and a leg. Whatever happened to knowing your customer instead of trying to be all things to all people?

Franchisee Incentives. Franchisees aren't building unless they get a deal. Franchisee development is down. No surprise here. They are acting just like the customers. Franchisee incentives are growing in importance.

Franchise Financing. Most franchisors at the conference acknowledged that franchisee financing was hard to come by. Domino's Pizza CFO Wendy Beck discussed how tough the financing markets were for newer franchisees. However, one obstacle to Domino's ability to get financing for their franchisees in this environment is their requirement that franchisees have no outside business interests. Unfortunately, this restriction eliminates a large group of multi-unit franchisee candidates who already have existing lending relationships and a history of cash flow. Franchisors might take a closer look at their franchisee criteria and see if it is working in today's capital market. With a few simple changes, more franchisee candidates might qualify for financing—an advantage in today's tight financing market.

Money Back to Shareholders. With primarily money managers in the audience, most of the presenting companies played up their free-cash flow generating abilities, and their ability to return cash to shareholders. With development expenses down because of little or no unit growth, public restaurant companies will be under pressure to return the cash flow to shareholders in the form of dividends and stock buybacks. Stock buybacks are good in the earnings per share calculation. Less shares, higher earnings per share, even if the profit number is the same.

RESTAURANT FINANCE MONITOR

2808 Anthony Lane South, Minneapolis, Minnesota 55418

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President: John M. Hamburger (jhamburger@restfinance.com)

Publisher: Mary Jo Larson (mlarson@franchisetimes.com) **Reporter:** Jonathan Maze (jmaze@franchisetimes.com)

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TO SUBSCRIBE CALL (800) 528-3296 FAX (612) 767-3230 www.restfinance.com