Troubled Restaurant Companies Poised For A Comeback Year

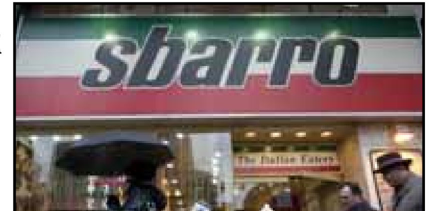
By Rachel Feintzeig

When restaurant chain Perkins & Marie Callender's Inc. sought bankruptcy protection last June, it needed an extra serving of help.

The company, saddled with a hefty debt load, had seen its revenue eroded by high unemployment and continued pain in the U.S. economy. Dwindling liquidity meant no funds to update restaurants that had gone stale, and the company couldn't make interest payments on its senior notes.

But Perkins hasn't met the same fate as so many other consumer-focused businesses, such as Borders Group Inc. and Filene's Basement LLC, which have had to shut their doors in the wake of the 2008 downturn. Perkins, which emerged from Chapter 11 protection in November, was able to swap debt, negotiate better rents and shutter some unprofitable locations.

Perkins is hardly unique. A number of restaurant chains that filed for bankruptcy in 2011 are now ripening into reorganizations and sales to buyers that would keep their doors open. Pizza and pasta chain Sbarro Inc. in early December emerged from Chapter 11 protection under the control of its lenders. West Coast pizza chain Round Table Pizza Inc. later in the month won permission to exit bankruptcy under a reorganization plan. Friendly Ice Cream Corp. was cleared to sell its assets to private equity firm Sun Capital Partners Inc. in late December. Real Mex Restaurants Inc. is also set to put its assets on the auction block in late January.



"They all seem like they will survive, albeit in a scaled-down version," said Normal Kinel, an attorney with Lowenstein Sandler who represented the creditors committee in the bankruptcy case of New York's iconic Tavern on the Green, which shut down in early 2010.

Restaurant companies seem to be particularly well suited to finding salvation in Chapter 11. Edward Sassower, a Kirkland & Ellis attorney who shepherded Sbarro through its bankruptcy, says they're "better able to access the tools

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of the Bankruptcy Code," including deleveraging, lease restructuring and the ability to obtain fresh capital.

Part of that is just by necessity—with only a few days' worth of food on hand and equipment that's not particularly valuable, there's not much to recover from liquidation. Lenders are well aware that they don't have much to gain from going-out-of-business sales, so they tend to push for going-concern sales or reorganizations, according to Gene Baldwin, a partner with advisory firm CRG Partners.

That leaves the restaurant companies with the task of shedding unprofitable locations and securing funds to give tired stores a facelift, two goals they can usually accomplish in Chapter 11.

"It's actually pretty healthy for them to go through this process," Baldwin said.

The restaurant industry itself has been getting healthier since 2008's recession wreaked havoc on an industry so dependent on consumer spending.

Hudson Riehle, the National Restaurant Association's senior vice president for research, called 2011 "the best operating environment for the industry" in the past four years. While stopping short of declaring a full rebound, he said that the industry is "going in the right direction."

Jim Yin, an analyst with Standard & Poor's, said he expects to see growth of about 3% across the industry in 2012, mirroring the growth seen in 2011. In an October report, Moody's said it's expecting an increase of up to 3% in operating profits over the next 12 to 18 months.

Baldwin thinks the friendlier environment might actually be sending some companies into the arms of the bankruptcy courts.

"When things are going down, down, down, it's hard for anybody to make a deal," he said. "But when things get better, it's easier to make a deal...everyone can see some value and they can move on."

Baldwin, Kinel and others see these recent restaurant bankruptcies mainly as balance-sheet cleanups, the legacy of boom-year leveraged buyouts that left acquisitions susceptible to recession-era pain.

"It's just taken three years at least for these companies to get to the point where they're ready now to get rid of all of this overhang of debt," Baldwin said.

Shedding debt is definitely a step in the right direction for these restaurant chains, but more work remains. They have to harness the power of their newfound financial security to make the right kinds of changes: facility upgrades, menu revamps, anything that will make formerly lackluster members of the casual dining, family dining and cafeteria sectors more relevant.

Some think success could be just around the well-financed corner.

"They're not so stale that they can't be revived," Kinel said. "They just need the capital."

But others, like Adam Hanft, the chief executive of marketing and branding firm Hanft Projects, harbor little hope for dated chains.

"Bankruptcy can't save a brand that's got a lot of tarnish," he said. It "can solve some financial and real-estate problems, but it can't solve branding problems."

Hanft cast an especially critical eye on Friendly's, saying he doesn't think any "radical reinvention" is possible for the decades-old chain, known for its Fribbles and Supermelt sandwiches.

A spokeswoman for Friendly's disagreed, saying the company's restructuring will allow it to "aggressively revitalize" its brand. The company has plans in the works to introduce new concepts—such as an ice-cream shop that will be co-branded with Burger King—and to build on its base of stores, she said in a statement.

Still, Hanft remains cautious about restaurant chains, like Friendly's, that are primarily situated in suburban or exurban areas. Those locations are playing witness to changing demographics and high unemployment in the wake of the recession, which could mean trouble for restaurants dependent on discretionary income.

Standard & Poor's identified the retail and restaurant sector as being one of the three "most troubled" in the U.S., according to a report released in December. The ratings agency gave Mastro's Restaurants LLC, which operates a chain of high-end steakhouse and seafood restaurants, and Buffets Inc., whose HomeTown Buffet, Old Country Buffet and Ryan's chains are bankruptcy veterans, a triple-C rating with a negative outlook.

Representatives for Mastro's didn't respond to requests for comment. A representative for Buffets declined to comment.

Michael Feder, a managing director with AlixPartners, said he wouldn't be surprised to see more bankruptcy filings in the first quarter of 2012. He's saving his rosier predictions for further down the line, when unemployment begins to ease and consumers have more cash to throw around.

"I think there's a lot of optimism," Feder said of the chains currently emerging from bankruptcy. "I think it remains to be seen how all those things will work out."

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