FURRS RESTAURANT GROUP INC
Form 10-Q
May 22, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 2, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NO. 1-10725

FURR'S RESTAURANT GROUP, INC.

INCORPORATED IN DELAWARE   IRS EMPLOYER IDENTIFICATION NO. 75-2350724

3001 E. PRESIDENT GEORGE BUSH HWY., SUITE 200, RICHARDSON, TEXAS 75082

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (972) 808-2923

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

YES X NO __

As of May 1, 2002 there were 9,767,926 shares of Common Stock outstanding.

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FURR'S RESTAURANT GROUP, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
APRIL 2, 2002 AND JANUARY 1, 2002
(Dollars in Thousands, Except Par Value Amounts)

	(Unaudited) April 2, 2002	January 1, 2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ -	$ -
Accounts and notes receivable (net of allowance for doubtful accounts of $105 and $108, respectively)	2,484	1,634
Inventories	7,449	6,771
Prepaid expenses and other	1,701	850

Total current assets	11,634	9,255
PROPERTY, PLANT AND EQUIPMENT NET:	43,896	45,389
DEFERRED TAX ASSET	18,582	18,926
DEFERRED LOAN COSTS	2,348	2,489
OTHER ASSETS	588	590
TOTAL ASSETS	$ 77,048	$ 76,649

(Continued)

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in Thousands)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles. These statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included in the Company s Form 10-K for the year ended January 1, 2002. In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation.

Interim results of operations may not be indicative of the results that may be expected for a full fiscal year.

2. Earnings Per Share

The following table reconciles the denominators of basic and diluted earnings per share for the thirteen-week periods ended April 2, 2002 and April 3, 2001.

	April 2, 2002	April 3, 2001

Weighted average common shares outstanding-basic	9,767,926	9,757,918
Options	2,733	-
Weighted average common shares outstanding-diluted	9,770,659	9,757,918

For the thirteen weeks ended April 2, 2002 and April 3, 2001, outstanding options totaling 829,843 and 743,000, respectively, were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive.

3. Income Taxes

We have provided income tax expense of $268 and $539 for the thirteen weeks ended April 2, 2002 and April 3, 2001, respectively. For the thirteen weeks ended April 3, 2001, the effective income tax rate is lower than the statutory Federal rate of 35% due to interest expense on restructured debt reduction, which is reported as debt rather than interest expense pursuant to Statement of Financial Accounting Standards No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings.

4. Debt

On April 10, 2001, the Company entered into a new $55 million Revolving Credit and Term Loan Agreement (Credit Agreement) with various banks and lenders that allows the Company to borrow at either a Federal Funds Rate plus an applicable margin or at a Eurocurrency Reserve Rate plus an applicable margin. The Credit Agreement contains covenants with regard to maintaining certain leverage ratios, achieving certain levels of EBITDA, operating cash flow and limits on capital expenditures. In addition there are certain restrictions on the payment of dividends and additional indebtedness. As a result of lower same-store sales,

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the Company is not in compliance with the minimum EBITDA and Leverage Ratio covenants required by its Credit Agreement as of April 2, 2002. The Company is discussing with its banks an amendment to the Credit Agreement to cure the covenant defaults. Management believes that such an amendment can be completed on terms that will not have a material adverse effect on the Company or its business plans. Because a definitive agreement reflecting the amendments has not been completed as of the date of this report, the Company s debt under the Credit Agreement is reflected as a current liability on its balance sheet. The Company is current in its payments under the Credit Agreement and the lenders have not issued a notice of default or taken other action under the Credit Agreement in response to the covenant defaults.

The Credit Agreement provides that the Company can borrow up to $20 million on a revolving basis until April, 2006, of which $9 million was drawn at closing. As of April 2, 2002, the Company had borrowings of $10.7 million on the revolver and $3.4 assigned to standby letters of credit related to the Company s workers compensation insurance policy. The remaining $5.9 million is available to be used for working capital and capital expenditures. The Credit Agreement contains a $30 million Term Loan A and a $5 million Term Loan B. The Term Loan A and Term Loan B provide for quarterly amortization through April, 2006 and April, 2007, respectively, with the remaining amounts outstanding then due. The Company s obligations under the Credit Agreement are secured by a security interest in and liens upon substantially all of the Company s assets.

5. Interest Rate Risk Management

The Company uses variable-rate debt to finance its operations. In particular, it has borrowed money under a Credit Agreement providing for variable-rate interest to retire the bonds and notes that were due December 31, 2001. This debt obligation exposes the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases and conversely, if interest rates decrease, interest expense also decreases.

Management believes it is prudent to limit the variability of a portion of its interest payments. It is the Company s objective to hedge between 50 and 70 percent of its variable-rate long-term note interest payments. The Company s Credit Agreement also requires that the Company hedge at least $20,000 for a period of two years.

To meet this requirement, the Company has entered into a derivative instrument, in the form of an interest rate swap, to manage fluctuations in cash flows resulting from interest rate risk. The interest rate swap changes the variable-rate cash flow exposure to fixed-rate cash flows by entering into a receive-variable, pay-fixed interest rate swap. Under the interest rate swap, which has a notional amount of $20,000 and a two-year term, the Company receives variable interest rate payments based on LIBOR and makes fixed interest rate payments at 4.99%. The Company accounts for the interest rate swap in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. SFAS No. 133 requires that all derivative instruments be recorded in the balance sheet at fair value. The interest rate swap is a cash flow hedge under SFAS No. 133 and, accordingly, changes in fair value are reported in other comprehensive income and such amounts are reclassified into interest expense as a yield adjustment in the same period in which the related expense on the variable rate debt affects operations.

The Company does not enter into derivative instruments for any purpose other than cash flow hedging purposes. That is, the Company does not speculate using derivative instruments.

The Company assesses interest rate cash flow risk by identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities.

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6. Business Segments

Following is a summary of segment information of the Company for the thirteen weeks ended April 2, 2002 and April 3, 2001:

	Cafeterias	Dynamic Foods	Total
2002:			
External revenues	$ 42,532	$ 745	$ 43,277
Intersegment revenues	-	14,187	14,187
Depreciation and amortization	1,973	249	2,222
Segment profit	1,378	82	1,460
2001:			
External revenues	$ 47,078	$ 409	$ 47,487
Intersegment revenues	-	14,424	14,424
Depreciation and amortization	2,337	263	2,600
Segment profit	2,014	511	2,525

Following is a reconciliation of reportable segments to the Company s consolidated totals for the thirteen weeks ended April 2, 2002 and April 3, 2001:

	April 2, 2002	April 3, 2001
Revenues		
Total revenues of reportable segments	$ 57,464	$ 61,911
Elimination of inter-segment revenue	(14,187)	(14,424)
Total consolidated revenues	$ 43,277	$ 47,487

7. Critical Accounting Policies

The Company follows certain significant accounting policies when preparing its consolidated financial statements. A complete summary of these policies is included in note 1 of notes to consolidated financial statements which are included in the Company s Form 10-K for the year ended January 1, 2002.

Certain of the policies require management to make significant and subjective estimates and assumptions which are sensitive to deviations of actual results from management s assumptions. In particular, management makes estimates regarding future undiscounted cash flows from the use of long-lived assets in assessing potential impairment whenever events or changes in circumstances indicate that the carrying value of a long-lived asset may not be recoverable and estimates of future taxable income when evaluating whether deferred tax assets are more likely than not recoverable.

Management has estimated future undiscounted net cash flows from the use of long-lived assets based on actual historical results and expectations of about future economic circumstances including future business volume, operating costs and conditions of local real estate markets. The estimate of future cash flows from the use and eventual disposition of the assets could change if actual business volume or operating costs differ due to industry conditions or other factors affecting our business environment, and if real estate markets in which the assets are located experience declines.

Management has estimated future taxable income in evaluating whether deferred tax assets are more likely than not recoverable. The estimate of future taxable income could change due to general economic conditions

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different than assumed by management, based on our ability to attract customers and compete in the marketplace and if operating costs are different than projected by management.

8. New Accounting Pronouncements

SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS No. 144 retains the fundamental provisions of SFAS No. 121 but eliminates the requirement to allocate goodwill to long-lived assets to be tested for impairment. This statement also requires discontinued operations to be carried at the lower of cost or fair value less costs to sell and broadens the presentation of discontinued operations to include a component of an entity rather than a segment of a business. The adoption of SFAS No. 144 did not have a material impact on the Company s results of operations or financial position.

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

Results of Operations

Sales for the first fiscal quarter of 2002 were $43.3 million, a decrease of $4.2 million from the same quarter of 2001. Operating income for the first quarter of 2002 was $1.4 million compared to $2.5 million in the comparable period in the prior year. Net income for the first quarter of 2002 was $.5 million, which includes a $.3 million gain on disposition of closed store obligations and $1 million of interest expense, compared to $2.3 million in the first quarter 2001, which includes a $.4 million gain on disposal of assets and $.1 million of interest expense.

Sales. Comparable unit sales decreased $2.6 million from first quarter 2001. Of this decrease, $3.5 million was due to decreased guest count while $.9 million was gained in increased ticket average. Guest traffic was impacted in the first quarter of 2002 by the decision to not media advertise during the design and implementation of our new menu, pricing and service format update. By the end of the first quarter 2002, there had been no media advertising for six months. First quarter 2001 sales included $1.9 million in sales from units that were subsequently closed during 2001. Sales by Dynamic Foods to third parties were $.3 million higher in first quarter 2002 than first quarter 2001.

Cost of sales. Excluding depreciation, cost of sales were 30.7% of sales for the first quarter of 2002 as compared to 28.1% for the same quarter of 2001. The increase in the cost of sales percent was due to increased product costs and cost associated with obtaining an American Institute of Baking Certification at Dynamic Foods.

Labor and related costs. Labor and related costs decreased $.8 million from first quarter 2001. The decrease was the result of stores closed during 2001, while labor and related costs for comparable stores were the same in first quarter 2002 as first quarter 2001, despite lower sales volume, due to cost of living increases in wages, increased benefit costs and reduced operational efficiencies as guest traffic decreases.

Occupancy and other expenses. Occupancy and other expenses decreased $1.4 million in first quarter 2002 from first quarter 2001. Of this decrease, $.5 million was due to stores that were closed during 2001, $.6 million is from decreased utilities cost in comparable stores and $.5 million in decreased advertising costs in comparable stores offset by $.2 million in increased repairs and maintenance, supplies and other expenses in comparable stores.

General and administrative expenses. General and administrative expenses decreased $.4 million in first quarter 2002 from first quarter 2001 due to lower salaries, bonuses and related benefits than in the prior year.

Depreciation and amortization. Depreciation and amortization expense was lower by $.4 million in the first quarter of 2002 of which, $.1 million was the result of asset disposals during 2001.

Gain on termination of closed store obligations. In connection with its Chapter 11 bankruptcy proceeding, Kmart rejected leases on three of our closed units and as a result, we were relieved of our obligation on these units and recognized a $.3 million gain.

Interest expense. Interest expense was $.9 million higher in the first quarter of 2002 due to the interest associated with the 12% Senior Secured Notes that was reported as additional debt rather than interest expense during first quarter 2001 pursuant to SFAS 15.

Income Taxes. Income tax expense of $.3 million was provided in the first quarter of 2002 compared to $.5 million provided in the first quarter of 2001. Our effective tax rate in first quarter 2001 was lower than the statutory Federal rate of 35% due to interest expense on restructured debt reduction, which is reported as debt rather than interest expense pursuant to Statement of Financial Accounting Standard No. 15, Accounting by Debtor and Creditors for Troubled Debt Restructurings.

Liquidity and Capital Resources

During the first quarter ended April 2, 2002, cash used in operating activities was $1.5 million compared to $1.9 million provided by operating activities in the same period of 2001. We made capital expenditures of $.9 million during the first quarter of 2002 compared to $.5 million during the same period of 2001. Due to the cash management arrangements available with our new revolving credit facility, cash and temporary investments were $0 and cash overdraft (included in accounts payable) was $.1 million at April 2, 2002 compared to $0 and $.4 million at January 1, 2002 and cash and temporary investments of $7.4 million at April 3, 2001. Our current ratio was .19:1 at April 2, 2002 compared to .69:1 at April 3, 2001 and .32:1 at January 1, 2002. Total assets at April 2, 2002 aggregated $77.0 million, compared to $86.0 million at April 3, 2001 and $76.6 million at January 1, 2002.

Our restaurants sales are collected immediately in cash or within several days from credit card companies. Funds available from cash sales are not needed to finance receivables and are not generally needed immediately to pay for food, supplies and certain other expenses of the restaurants. Therefore, the business and operations of the Company have not historically required proportionately large amounts of working capital, which is generally common among similar restaurant companies.

On April 10, 2001, we entered into a new $55 million Revolving Credit and Term Loan Agreement (Credit Agreement) with various banks and lenders that allows us to borrow at either a Federal Funds Rate plus an applicable margin or at a Eurocurrency Reserve Rate plus an applicable margin. The Credit Agreement contains covenants with regard to maintaining certain leverage ratios, achieving certain levels of EBITDA, operating cash flow and limits on capital expenditures. In addition there are certain restrictions on the payment of dividends and additional indebtedness. As a result of lower same-store sales, we are not in compliance with the minimum EBITDA and Leverage Ratio covenants required by our Credit Agreement as of April 2, 2002. We are discussing with our banks an amendment to the Credit Agreement to cure the covenant defaults. We believe that such an amendment can be completed on terms that will not have a material adverse effect on us or our business plans. Because a definitive agreement reflecting the amendments has not been completed as of the date of this report, our debt under the Credit Agreement is reflected as a current liability on our balance sheet. We are current in our payments under the Credit Agreement and the lenders have not issued a notice of default or taken other action under the Credit Agreement in response to the covenant defaults.

The Credit Agreement provides that we can borrow up to $20 million on a revolving basis until April, 2006, of which $9 million was drawn at closing. As of April 2, 2002, we had borrowings of $10.7 million on the revolver and $3.4 assigned to standby letters of credit related to the Company s workers compensation insurance policy. The remaining $5.9 million is available to be used for working capital and capital expenditures. The Credit Agreement contains a $30 million Term Loan A and a $5 million Term Loan B. The Term Loan A and Term Loan B provide for quarterly amortization through April, 2006 and April, 2007, respectively, with the remaining amounts outstanding then due. Our obligations under the Credit Agreement are secured by a security interest in and liens upon substantially all of our assets.

As a result of retiring the 12% Senior Secured Notes, we reported an extraordinary pre-tax gain of $3.6 million in the second quarter of fiscal 2001.

We operate 38 restaurants which are leased from Kmart. Kmart filed a Chapter 11 bankruptcy proceeding in January, 2002 and has subsequently rejected one of our ground leases and 10 of our full premise leases and has announced its intent to reject an additional 22 of our full premise leases. We have negotiated a new lease with the landlord on one of the rejected full premise leases and are currently in negotiations with the landlord of the other nine rejected full premise leases. We believe that the United States Bankruptcy Code, applicable state laws and the doubtful existence of more valuable uses of the leased premises will support our continued occupancy of the Kmart leased premises without material effect. The loss of possession of some of these restaurants could have a material adverse effect upon our results of operations, financial position and liquidity.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

We are exposed to market risk from changes in commodity prices. We purchase certain commodities used in food preparation. These commodities are generally purchased based upon market prices established with vendors. These purchase arrangements may contain contractual features that limit the price paid by establishing certain price floors or caps. We do not use financial instruments to hedge commodity prices because these purchase arrangements help control the ultimate cost paid and any commodity price aberrations are generally short term in nature.

We are exposed to market risk from changes in interest rates affecting our variable rate debt. We use an interest rate swap to manage the cash flow risk on $20 million of our variable rate debt. The annual impact on our results of operations of a one-point interest rate change on the outstanding balance of our variable rate debt is approximately $400 thousand. We do not use derivatives for trading purposes.

This market risk discussion contains forward-looking statements. Actual results may differ materially from this discussion based upon general market conditions and changes in domestic and global financial markets.

PART II. OTHER INFORMATION

Item 1. Legal Proceeding

None.

Items 2, 3, 4 and 5 are not applicable and have been intentionally omitted.

Item 6. Exhibits and Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: May 22, 2002 FURR'S RESTAURANT GROUP, INC.

/s/ Craig S. Miller
Craig S. Miller
President and Chief Executive Officer
(Chief Financial Officer)

/s/ Nancy A. Ellefson
Nancy A. Ellefson
Vice President - Finance
(Chief Accounting Officer)

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