

## Fitch: Possible Restaurant Bankruptcies Show Industry Challenges

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NEW YORK--( [BUSINESS WIRE](#) )--Two potential bankruptcies are a warning sign of financial distress among restaurant chains, according to Fitch Ratings. We do not view them as portending a widespread increase in bankruptcies of U.S. restaurants but a reflection of difficulties faced by brands that have lost their competitive position and relevancy with consumers.

Quizno's and Sbarro, LLC, two privately held mid-sized restaurant chains struggling to grow sales for years, are reportedly in the process of preparing bankruptcy filings. The total debt involved in these potential restructurings is approximately \$570 million for Quizno's and \$140 million for Sbarro.

The Quizno's and Sbarro situations reflect the difficulties faced by brands that have lost their competitive position and relevancy with consumers. In the case of Quizno's, it also underscores highly levered restaurant chains with a dysfunctional franchise system.

At the end of 2012, nearly 100% of Quizno's 1,912 units and 30% of Sbarro's 591 units in the U.S. were franchised, according to Nation's Restaurant News. Both firms have experienced consecutive years of net restaurant closures and have lost market share to competitors including Subway, Jimmy John, Gourmet Sandwiches, Little Caesars, and Papa John's.

According to several news reports, Sbarro is supposedly negotiating a prepackaged bankruptcy plan of reorganization with lenders and could file for bankruptcy within several days. This would mark a second trip to bankruptcy court for the chain. Its first Chapter 11 filing occurred in April 2011 as a result of rising food costs and a slowdown in consumer spending and mall traffic. Fitch believes a levered balance sheet, continuing slow economic growth, and a shift in consumer shopping habits (which is reducing mall traffic) are likely culprits behind Sbarro's potential Chapter 22 filing.

In its prior bankruptcy reorganization, Sbarro reduced total debt to approximately \$130 million from \$368 million. First lien lenders recovered 70 cents on the dollar in the form of a new exit loan facility and 100% of the new common stock. The claims of second lien lenders and unsecured note holders received 0% recovery as the first lien creditors took the whole pie. Proposed creditor recoveries in the plan now under negotiation are not

yet available.

A repeated theme of restaurant chain bankruptcies is companies using the process to reject or restructure burdensome operating leases to reduce expenses while being protected from creditors. Restaurants often take the opportunity to close unprofitable locations and typically emerge as smaller chains. Restaurants also try to improve profitability in bankruptcy through the sale or licensing of trademarks and other intellectual property.

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com).

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at [www.fitchratings.com](http://www.fitchratings.com). All opinions expressed are those of Fitch Ratings.

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