

FURRS RESTAURANT GROUP INC  
Form 10-Q  
November 15, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 1, 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  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act).

YES  NO

---

As of November 8, 2002 there were 9,767,926 shares of Common Stock outstanding.

1

---

FURR'S RESTAURANT GROUP, INC.

INDEX

PART I.	FINANCIAL INFORMATION	<u>PAGE</u>
Item 1.	Financial Statements	

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

	Condensed Consolidated Balance Sheets - October 1, 2002 (Unaudited) and January 1, 2002	3
	Unaudited Condensed Consolidated Statements of Operations - For the thirteen weeks ended October 1, 2002 and October 2, 2001	5
	Unaudited Condensed Consolidated Statements of Operations - For the thirty-nine weeks ended October 1, 2002 and October 2, 2001	6
	Unaudited Consolidated Statement of Changes in Stockholders' Equity (Deficit) - For the thirty-nine weeks ended October 1, 2002	7
	Unaudited Condensed Consolidated Statements of Cash Flows - For the thirty-nine weeks ended October 1, 2002 and October 2, 2001	8
	Notes to Unaudited Condensed Consolidated Financial Statements	9
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosure About Market Risk	22
Item 4.	Controls and Procedures	22
PART II.	OTHER INFORMATION	
Item 3.	Defaults Upon Senior Securities	22
Item 6.	Exhibits and reports on Form 8-K	23
SIGNATURES		23

---

### PART I. FINANCIAL INFORMATION

#### Item 1. Financial Statements

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES  
-----

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

Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

	(Unaudited) October 1, 2002
	-----
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 1,061
Accounts and notes receivable (net of allowance for doubtful accounts of \$100 and \$108, respectively)	1,396
Inventories	6,823
Prepaid expenses and other	1,640
	-----
Total current assets	10,920
	-----
PROPERTY, PLANT AND EQUIPMENT, NET	38,203
DEFERRED TAX ASSET	-
DEFERRED LOAN COSTS	2,088
OTHER ASSETS	650
	-----
TOTAL ASSETS	\$ 51,861
	=====

(Continued)

3

---

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

-----

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

-----

(Unaudited)  
October 1,  
2002

-----

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

### LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

#### CURRENT LIABILITIES:

Current maturities of long-term debt	\$ 7,650
Trade accounts payable	9,531
Other payables and accrued expenses	14,566
Derivative liability, current	357
Reserve for store closings, current	1,236
Long-term debt classified as current (Note 5)	34,275

Total current liabilities	67,615
---------------------------	--------

RESERVE FOR STORE CLOSINGS, NET OF CURRENT PORTION	4,704
--	-------

LONG-TERM DEBT, NET OF CURRENT MATURITIES	-
---	---

OTHER PAYABLES	8,826
----------------	-------

DERIVATIVE LIABILITY, NET OF CURRENT PORTION	-
--	---

EXCESS OF FUTURE LEASE PAYMENTS OVER FAIR VALUE NET OF AMORTIZATION	647
--	-----

#### COMMITMENTS AND CONTINGENCIES

#### STOCKHOLDERS' EQUITY (DEFICIT):

Preferred Stock, \$.01 par value; 5,000,000 shares authorized, none issued	
Common Stock, \$.01 par value; 15,000,000 shares authorized, 9,767,926 issued and outstanding	98
Additional paid-in capital	56,407
Accumulated other comprehensive loss	(6,269)
Accumulated deficit	(80,167)

Total stockholders' equity (deficit)	(29,931)
--------------------------------------	----------

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$ 51,861
--	-----------

See accompanying notes to condensed consolidated financial statements.

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THIRTEEN WEEKS ENDED OCTOBER 1, 2002 AND OCTOBER 2, 2001  
(Dollars in Thousands, Except Per Share Amounts)

	Thirteen weeks ended
	October 1,                      October 1,

Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

	2002	2001
	-----	-----
Sales	\$ 39,821	\$ 40,121
Costs and expenses:		
Cost of sales (excluding depreciation)	13,107	13,107
Labor and related costs	15,575	15,575
Occupancy and other expenses	8,708	8,708
General and administrative expenses	2,114	2,114
(Gain) Loss on store closings	3,672	3,672
Depreciation and amortization	3,837	3,837
	-----	-----
	47,013	47,013
	-----	-----
Operating income (loss)	(7,192)	(7,192)
Gain on disposal of assets	343	343
Interest expense	1,309	1,309
	-----	-----
Earnings (loss) before income taxes	(8,158)	(8,158)
Income tax benefit	-	-
	-----	-----
Net income (loss)	\$ (8,158)	\$ (8,158)
	=====	=====
Weighted average shares:		
Basic	9,767,926	9,767,926
	=====	=====
Diluted	9,767,926	9,770,000
	=====	=====
Net income (loss) per share:		
Basic	\$ (.84)	\$ (.84)
	=====	=====
Diluted	\$ (.84)	\$ (.84)
	=====	=====

See accompanying notes to condensed consolidated financial statements.

# Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

(Dollars in Thousands, Except Per Share Amounts)

	Thirty-nine weeks end	
	October 1, 2002	Octo 2
Sales	\$ 124,633	\$ 14
Costs and expenses:		
Cost of sales (excluding depreciation)	40,221	4
Labor and related costs	47,153	4
Occupancy and other expenses	27,474	2
General and administrative expenses	6,699	
Loss on store closings, net of gain on termination of closed store obligations	3,380	
Depreciation and amortization	9,352	
	134,279	13
Operating income (loss)	(9,646)	
Gain on disposal of assets	355	
Interest expense	3,278	
Earnings (loss) before income taxes and extraordinary item	(12,569)	
Income tax expense	18,710	
Earnings (loss) before extraordinary item	(31,279)	
Extraordinary gain on retirement of debt	-	
Net income (loss)	\$ (31,279)	\$
Weighted average shares:		
Basic	9,767,926	9,75
Diluted	9,767,926	9,76
Earnings (loss) before extraordinary item per share:		
Basic	\$ (3.20)	\$
Diluted	\$ (3.20)	\$
Extraordinary item per share:		
Basic	-	\$
Diluted	-	\$
Net income (loss) per share:		
Basic	\$ (3.20)	\$

Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

Diluted

=====  
\$ (3.20)  
=====

=====  
\$  
=====

See accompanying notes to condensed consolidated financial statements.

6

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES  
-----

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS'  
FOR THE THIRTY-NINE WEEKS ENDED OCTOBER 1, 2002  
(Dollars in Thousands)  
-----

	Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss
	-----	-----	-----	-----
BALANCE, JANUARY 1, 2002	\$ -	\$ 98	\$ 56,407	\$ (6,286)
Change in fair value of estimated cash flows related to interest rate swap	-	-	-	(451)
Reclassification of interest rate swap to earnings	-	-	-	468
Net loss	-	-	-	-
	-----	-----	-----	-----
BALANCE, OCTOBER 1, 2002	\$ -	\$ 98	\$ 56,407	\$ (6,269)
	=====	=====	=====	=====

Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

See accompanying notes to condensed consolidated financial statements.

7

FURR'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in Thousands)

	Thirty-nin October 1, 2002
Cash flows from operating activities:	
Net income (loss)	\$ (31,279)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Amortization of deferred loan cost	453
Depreciation and amortization	9,352
Deferred tax expense	18,710
Loss on store closings, net of gain on termination of closed store lease obligations	3,380
Gain on disposal of assets	(355)
Extraordinary gain on debt refinancing	-
Changes in operating assets and liabilities:	
Accounts and notes receivable	238
Inventories	(52)
Prepaid expenses and other	(634)
Reserve for store closings	(90)
Trade accounts payable, other payables, accrued expenses and other liabilities	711
Net cash provided by operating activities	434
Cash flows provided by (used in) investing activities:	
Purchases of property, plant and equipment	(2,246)
Proceeds from the sale or disposal of property, plant and equipment	-
Net cash provided by (used in) investing activities	(2,246)
Cash flows provided by financing activities:	
Payment of indebtedness	(1,275)
Payment of loan costs	(52)
Increase in cash overdraft	-
Net borrowing on revolver	4,200
Issuance of stock	
Net cash provided by (used in) financing activities	2,873
Increase (decrease) in cash and cash equivalents	1,061



## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

Cash and cash equivalents at beginning of period		----- -
Cash and cash equivalents at end of period		\$ 1,061 =====
Supplemental disclosure of cash flow information:		
Cash paid for interest (including \$3,364 in 2001 classified as payment of indebtedness)		\$ 1,719 =====
Cash paid for income taxes		\$ - =====
Non-cash investing and financing activities:		
Receivable related to involuntary equipment conversion		\$ - =====
See accompanying notes to condensed consolidated financial statements.		

8

---

### 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 periods ended October 1, 2002 and October 2, 2001.

	Thirteen Weeks Ended		Thirty-ni
	October 1, 2002	October 2, 2001	October 1, 2002
	-----	-----	-----
Weighted average common shares outstanding-basic	9,767,926	9,767,926	9,767,926
Options	-	3,277	-
	-----	-----	-----
Weighted average common shares outstanding-diluted	9,767,926	9,771,203	9,767,926
	=====	=====	=====

The following table sets forth the options that were not included in the computation of diluted earnings per share because their exercise price was greater than the average market price of the common shares and therefore, the effect would be anti-dilutive.

#### 1. Basis of Presentation

9

Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

	Thirteen Weeks Ended		Thirty-ni
	October 1, 2002	October 2, 2001	October 1, 2002
Options	1,484,834	531,000	1,484,834

9

**3. Comprehensive Income**

The following table sets for the components of comprehensive income for the periods ended October 1, 2002 and October 2, 2001:

	Thirteen Weeks Ended		Thirty-ni
	October 1, 2002	October 2, 2001	October 1, 2002
Net income (loss)	\$ (8,158)	\$ 1,235	\$ (31,279)
Fair value of interest rate swap, net of tax in 2001	66	(195)	17
	\$ (8,092)	\$ 1,040	\$ (31,262)

**4. Income Taxes**

The Company provided income tax expense (benefit) of \$0 and (\$349) for the thirteen weeks ended October 1, 2002 and October 2, 2001, respectively, and income tax expense of \$18,710 and \$89 for the thirty-nine weeks ended on the same dates, respectively. During the thirty-nine weeks ended October 1, 2002, the Company's deferred tax asset was reduced by \$18,442 through an increase in the valuation allowance. This action, which will not adversely affect the Company's cash flows or liquidity, was taken based on the Company's review of its recent operating results and the Company's existing defaults under its credit agreement, which management believes create substantial uncertainty regarding the Company's ability in the near term to recover the asset by utilizing existing net operating losses available for carryforward to reduce future taxable income. Management does not believe it has sufficient information at this time to determine what portion, if any, of the tax asset might be recoverable over the longer term if the existing defaults of the Company's credit agreement are resolved and the Company's operating performance recovers to previous levels. Accordingly, a valuation allowance has been provided for the entire amount of the asset. The Company intends to review this determination on a periodic basis and, if conditions justify, may determine that it is appropriate to recognize some amount of deferred tax asset by decreasing the valuation allowance at a future date. No assurance can be given as to the timing or amount of any such action.

For the periods ended in 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 ("SFAS 15")." There is no income tax expense associated with the extraordinary gain as this represents early disposition of the remaining restructured debt interest under SFAS 15.

**5. Debt and Liquidity**

On April 10, 2001, the Company entered into a \$55,000 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 incurrence of additional indebtedness.

10

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

The Credit Agreement provides that the Company can borrow up to \$20,000 on a revolving basis until April, 2006, of which \$9,000 was drawn at closing. As of October 1, 2002, the Company had borrowings of \$11,200 on the revolver and \$3,400 assigned to standby letters of credit related to the Company's workers' compensation insurance policy. The remaining \$5,400 would be available to be used for working capital and capital expenditures in the absence of the defaults existing under the Credit Agreement discussed below. The Credit Agreement contains a \$30,000 Term Loan A and a \$5,000 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.

The Company's reduced sales during the first thirty-nine weeks of 2002 contributed to the Company's operating losses and a significant reduction in its cash flow. The Company has continued to be out of compliance with the financial ratio and other covenants required by its Credit Agreement as of October 1, 2002. These defaults have resulted in the lenders' refusal to make further advances under the revolving portion of the Credit Agreement since May 2002, requiring the Company to operate based on its available cash flow during this period. The Company has taken a number of actions to conserve and manage its cash, including withholding two principal payments of \$1,275 each under the Credit Agreement that were due July 2, 2002 and October 1, 2002. The Company also had unpaid accrued interest of \$1,188 as of October 1, 2002.

The Company has entered into a Limited Forbearance Agreement (the "Agreement") with its lenders pursuant to which they have agreed not to exercise their remedies under the Credit Agreement in response to the existing defaults for a period ending December 31, 2002. The Agreement contains disclosures of the existing defaults under the Credit Agreement and general releases of any claims that the Company might have against the lenders, and requires expanded and more frequent reporting to the lenders, compliance with new cash flow and cash balance targets, as well as continuing compliance with the provisions of the Credit Agreement that are not the subject of existing defaults, weekly partial interest payments in the amount of \$50, accrual of interest under the Credit Agreement at the default rate and the submission to the lenders of a business plan for fiscal year 2003. The Company also agreed that it would not terminate, amend, modify or supplement its agreement with Corporate Revitalization Partners, the Company's financial advisers, without the prior consent of the lenders.

The lenders' agreement to forbear terminates automatically on December 31, 2002, and is subject to earlier termination by the lenders if the Company fails to comply with the Agreement, if a bankruptcy petition is filed by or against the Company, if an event occurs which would have a material adverse effect on the Company, or if additional defaults occur under the Credit Agreement. Upon any termination of the Agreement, the lenders could seek to exercise their remedies under the Credit Agreement, including foreclosing upon and selling or otherwise disposing of the Company's assets which secure the Company's obligations under the Credit Agreement, any of which could significantly and negatively impact the Company's financial condition and operating results. If the lenders seek to exercise their remedies under the Credit Agreement, the Company will be forced to consider filing a petition for relief in United States Bankruptcy Court. Because of the existing defaults and the short-term nature of the Agreement, the Company's debt under the Credit Agreement is reflected as a current liability on its balance sheet.

### **6. Reserve for Store Closings**

When the decision to close a restaurant is made, the present value of all fixed and determinable costs to be incurred after operations cease is accrued. These fixed and determinable costs consist primarily of obligations defined in lease agreements such as rent and common area maintenance, reduced by sublease income, if any. The Company closed six restaurants during the third quarter of 2002 and recognized a \$3,700 loss.

11

---

### **7. Long-Lived Asset Impairment**

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company groups and evaluates its assets for impairment at the individual restaurant level. The Company considers a restaurant's assets to be impaired if a forecast of undiscounted future cash flows directly related to the assets, including disposal value, if any, is less than the carrying amount. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Charges of \$1,600 and \$2,500 for the third quarter of 2002 and the first thirty-nine weeks of 2002, respectively, were recorded to recognize the write-down of certain property, plant and equipment to estimated fair value, based on expected future cash flows.

### **8. 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.

### **5. Debt and Liquidity**

11

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

Management believes it is prudent to limit the variability of a portion of its interest payments. It has been 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 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 changed the variable-rate cash flow exposure to fixed-rate cash flows by creating a receive-variable, pay-fixed interest rate swap. Under the interest rate swap, which had a notional amount of \$20,000 and a two-year term, the Company received variable interest rate payments based on LIBOR and made fixed interest rate payments at 4.99%.

Another action the Company has taken to conserve and manage cash, has been to withhold payments due pursuant to the derivative instrument. As a result, the instrument was terminated on September 12, 2002 with a settlement value of \$486 and unpaid interest amounts of \$153 for a total market quotation amount of \$639, which is reflected on the Company's balance sheet as a current liability. In accordance with SFAS 133, since the derivative has been terminated, the losses in other comprehensive income will be reclassified to earnings in the same period or periods during which the hedged forecasted transaction affects earnings.

The Company has accounted 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 was a cash flow hedge under SFAS No. 133 and, accordingly, changes in fair value have been 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.

12

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.

### 9. Business Segments

Following is a summary of segment information of the Company for the specified amounts that are included in the measure of segment profit or loss reviewed by the chief operating decision maker for the thirteen weeks ended October 1, 2002 and October 2, 2001:

	Cafeterias	Dynamic Foods
2002:		
External revenues	\$ 38,851	\$ 970
Intersegment revenues	-	13,114
Depreciation and amortization	3,585	252
Segment profit (loss)	(7,324)	132
2001:		
External revenues	\$ 44,857	\$ 494
Intersegment revenues	-	12,764
Depreciation and amortization	2,096	258
Segment profit	1,722	270

Following is a summary of segment information of the Company for the specified amounts that are included in the measure of segment profit or loss reviewed by the chief operating decision maker for the thirty-nine weeks ended October 1, 2002 and October 2, 2001:

	Cafeterias	Dynamic Foods
2002:		
External revenues	\$ 121,561	\$ 3,072
Intersegment revenues	-	41,525
Depreciation and amortization	8,599	753

### 8. Interest Rate Risk Management

12

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

Segment profit (loss)	(10,052)	406
2001:		
External revenues	\$ 139,068	\$ 1,325
Intersegment revenues	-	42,539
Depreciation and amortization	7,220	782
Segment profit	4,771	1,109

13

Following is a reconciliation of reportable segments to the Company's consolidated totals for the periods ended October 1, 2002 and October 2, 2001:

	Thirteen Weeks Ended		Thirty-nin
	October 1, 2002	October 2, 2001	October 1, 2002
Revenues			
Total revenues of reportable segments	\$ 52,935	\$ 58,115	\$166,158
Elimination of inter-segment revenue	(13,114)	(12,764)	(41,525)
Total consolidated revenues	\$ 39,821	\$ 45,351	\$124,633

### 10. Pension Plan

During fiscal 2002, the Company withheld legally required minimum funding payments due to its noncontributory defined benefit pension plan (the "Plan") totaling \$764. The Company is liable for the contributions to the Plan to meet the minimum funding requirements. The Company will be liable for interest and, in some instances, excise taxes on the withheld payments. The Company's limited available cash flow is expected to continue to adversely affect the ability of the Company to meet its funding obligations to the Plan during the remainder of 2002 and into 2003. The Company's failure to make the payments necessary to satisfy the minimum funding requirements for the Plan has been reported to the Pension Benefit Guaranty Corporation ("PBGC"), but no action has been taken by the PBGC at this time. If the Company's efforts to improve its cash flow to a level that will allow the required payments to the Plan to be made are not successful, the PBGC may take various statutorily prescribed actions to protect the Plan's assets and benefits, including asserting a statutory lien against the Company's property, taking control of and operating the Plan, terminating the Plan and pursuing legal action against the Company to recover the Plan's funding deficiency. In addition to the PBGC, the Plan, the Plan fiduciaries and/or participants and beneficiaries may sue to compel the Company to meet the Plan's minimum funding requirements. If the Plan is terminated all benefits will become immediately payable, the specific amount of which will depend upon the applicable actuarial assumptions for the Plan. The Plan termination liability was estimated to be \$9,100 as of January 1, 2002. Based on financial market developments during 2002, management believes that the Plan's termination liability has increased since January 1, 2002.

### 11. 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.

14

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

## Results of Operations

### Thirteen Weeks Ended October 1, 2002 Compared to Thirteen Weeks Ended October 2, 2001:

Sales for the third fiscal quarter of 2002 were \$39.8 million, a decrease of \$5.5 million from the same quarter of 2001. Operating loss for the third quarter of 2002 was \$7.2 million compared to \$2.0 million of operating income in the comparable period in the prior year. Net loss for the third quarter of 2002 was \$8.2 million compared to net income of \$1.2 million in the third quarter 2001.

We believe the significant decline in sales and resulting decline in operating cash flow experienced during the first thirty-nine weeks of 2002 is attributable to a combination of factors: (i) the failure of our effort to reposition our service offering and pricing scheme beginning in April 2002 and our increased advertising expenditures in the second quarter to attract guests to our restaurants, (ii) increased competition from other cafeteria and family dining operators who have begun to offer all-you-can eat pricing and other reduced price selections to their customers, (iii) the continuation of downward trends in customer traffic experienced by the Company and other cafeteria operators, which has been exacerbated by the age, location and condition of some of our restaurants and (iv) the effects on our guests of continuing adverse developments in the economy. In the face of declining sales, our limited ability to decrease our fixed costs, principally rent, utilities and payroll, has resulted in a substantial increase in the number of units experiencing operating losses during this period.

Sales. Comparable unit sales decreased 12.2%, or \$5.4 million, from third quarter 2001. Of this decrease, \$4.8 million was due to decreased guest count while \$.6 million was lost in decreased ticket average. Third quarter 2001 sales included \$.6 million in sales from units that were subsequently closed. Sales by Dynamic Foods to third parties were \$.5 million higher in third quarter 2002 than third quarter 2001.

Cost of sales. Excluding depreciation, cost of sales was 32.9% of sales for the third quarter of 2002 as compared to 28.8% for the same quarter of 2001. Cost of sales in the restaurants excluding cost of sales to third parties by Dynamic Foods, were 30.6% of sales for the third quarter of 2002 compared to 28.0% for the same quarter of 2001. The increase in the cost of sales percentage was due to increased product costs and improvement in food quality and additional premium items offered to customers during the first half of the quarter.

Labor and related costs. Labor and related costs decreased \$.6 million from third quarter 2001. \$.3 million of the decrease was the result of stores that closed since third quarter 2001, and labor and related costs for comparable stores decreased by \$.3 million from third quarter 2001 due to lower sales volume.

Occupancy and other expenses. Occupancy and other expenses decreased \$1.0 million in third quarter 2002 from third quarter 2001. Of this decrease, \$.3 million was due to decreased marketing expense in comparable stores, \$.3 million of cost in stores that were closed since third quarter 2001 and \$.3 million from decreased utilities cost in comparable stores.

General and administrative expenses. General and administrative expenses were comparable in third quarter 2002 and third quarter 2001 as cost reductions implemented in response to our negative operating results have been offset by increased costs attributable to our financial and other professional advisors.

Depreciation and amortization. Depreciation and amortization expense was higher by \$1.5 million in the third quarter of 2002 and includes a \$1.6 million write-down of impaired assets. We and

---

our advisors continue to assess the financial performance of our assets which may result in additional impairment charges.

Loss on store closings. We closed six stores during third quarter of 2002 and recognized a \$3.7 million loss on store closings for future lease, tax and insurance liability on the properties. We and our advisors continue to assess the financial performance of our stores which may result in additional store closings and loss from store closings.

Income Taxes. Income tax expense of \$0 was provided in the third quarter of 2002 compared to \$349 thousand of benefit provided in the third quarter of 2001. Our effective tax rate in third 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."

### Thirty-Nine Weeks Ended October 1, 2002 Compared to Thirty-nine Weeks Ended October 2, 2001:

Sales for the first thirty-nine weeks of 2002 were \$124.6 million, a decrease of \$15.8 million from the same period 2001. Operating loss for the first thirty-nine weeks of 2002 was \$9.6 million compared to \$5.9 million of operating income in the comparable period in the prior year. Net

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

loss for the first thirty-nine weeks of 2002 was \$31.3 million, which includes \$18.7 million of income tax expense, compared to net income of \$7.5 million in the first thirty-nine weeks of 2001, which includes a \$3.6 million extraordinary gain on retirement of debt and \$.1 million of income tax expense.

Sales. Comparable unit sales decreased 9.8%, or \$13.1 million, from the first thirty-nine weeks of 2001. Of this decrease, \$14.3 million was due to decreased guest count while \$1.2 million was gained in increased ticket average. The first thirty-nine weeks of 2001 sales included \$4.4 million in sales from units that were subsequently closed. Sales by Dynamic Foods to third parties were \$1.7 million higher in the first thirty-nine weeks of 2002 than the same period of 2001.

Cost of sales. Excluding depreciation, cost of sales were 32.3% of sales for the first thirty-nine weeks of 2002 as compared to 28.7% for the same period of 2001. Cost of sales in the restaurants excluding cost for sales to third parties by Dynamic Foods, were 30.5% of sales for the first thirty-nine weeks of 2002 compared to 28.1% for the same period of 2001. The increase in the cost of sales percent was due to increased product costs and improvement in food quality and additional premium items offered to customers during the second half of the second quarter and first half of the third quarter of 2002.

Labor and related costs. Labor and related costs decreased \$2.7 million from the first thirty-nine weeks of 2001. \$1.7 million of the decrease was the result of stores that closed since third quarter 2001, and labor and related costs for comparable stores decreased by \$1.0 million from second quarter 2001 due to lower sales volume.

Occupancy and other expenses. Occupancy and other expenses decreased \$1.5 million in first thirty-nine weeks of 2002 from the same period 2001. Of this decrease, \$1.3 million was due to stores that closed during 2001 and \$1.2 million decreased utilities cost in comparable stores, offset by \$.6 million of increased marketing cost and \$.4 million increase in repairs and maintenance and other store expense.

General and administrative expenses. General and administrative expenses were \$.5 million less in the first thirty-nine weeks of 2002 than the same period 2001 due to lower salaries and bonuses accrued during the first thirty-nine weeks of 2002.

16

---

Depreciation and amortization. Depreciation and amortization expense was higher by \$1.4 million in the first thirty-nine weeks of 2002 and includes a \$2.5 million write-down of impaired assets. Depreciation and amortization expense in the first thirty-nine weeks of 2001 included a \$.6 million write-down of impaired assets. We and our advisors continue to assess the financial performance of our assets which may result in additional impairment charges.

Loss on store closings, net of gain on termination of closed store obligations. We closed six stores during 2002 and recognized a \$3.7 million loss on store closings for future lease, tax and insurance liability on the properties. In connection with its Chapter 11 bankruptcy proceeding, Kmart "rejected" leases on three of our previously closed units, and as a result, we were relieved of our obligation on these units and recognized a \$.3 million gain. We and our advisors continue to assess the financial performance of our stores which may result in additional store closings and loss from store closings.

Income Taxes. Income tax expense of \$18.7 million was provided in the thirty-nine weeks of 2002 compared to \$.1 million of expense provided in the same period of 2001. During the thirty-nine weeks ended October 1, 2002, our deferred tax asset was reduced by \$18.4 million through an increase in the valuation allowance. This action, which will not adversely affect our cash flows or liquidity, was taken based on our review of our recent operating results, and our existing defaults under our credit agreement, which we believe creates substantial uncertainty regarding our ability in the near term to recover the asset by utilizing existing net operating losses available for carryforward to reduce future taxable income. We do not believe we have sufficient information at this time to determine what portion, if any, of the tax asset might be recoverable over the longer term if the existing defaults of our credit agreement are resolved and our operating performance recovers to previous levels. Accordingly, the entire amount of the asset has been reduced. We intend to review this determination on a periodic basis and, if conditions justify, may determine that it is appropriate to recognize some amount of deferred tax asset by decreasing the valuation allowance at a future date. No assurance can be given as to the timing or amount of any such action. Our effective tax rate in 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."

Extraordinary gain on retirement of debt. As a result of retiring the 12% senior secured notes, we reported an extraordinary gain of \$3.6 million in the second quarter of fiscal 2001.

**Liquidity and Capital Resources**

Cash provided by operations during the third quarter of 2002 was \$1.6 million compared to \$1.3 million used in operations during the third quarter of 2001. During the first three quarters ended October 1, 2002, cash provided by operating activities was \$4 million compared to \$4.9 million provided by operating activities in the same period of 2001. We made capital expenditures of \$2.2 million during the first thirty-nine weeks of 2002 compared to \$2.0 million during the same period of 2001. Cash and temporary investments were \$1.1 million at October 1, 2002, compared to cash and temporary investments of \$0 and cash overdraft (included in accounts payable) of \$4 million at January 1, 2002 and \$0 and \$2.4 million at October 2, 2001. Overdraft amounts are due to the cash management arrangements under our revolving credit facility. Our ability to obtain advances under this facility terminated in May 2002. Our current ratio was .16:1 at October 1, 2002 compared to .45:1 at October 2, 2001 and .32:1 at January 1, 2002. Total assets at October 1, 2002 aggregated \$51.9 million, compared to \$80.8 million at October 2, 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

17

---

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 \$55 million Revolving Credit and Term Loan Agreement (Credit Agreement) with various banks and lenders that allowed 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 incurrence of additional indebtedness. 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.

The Credit Agreement provided for borrowing up to \$20 million on a revolving basis until April, 2006, of which \$9 million was drawn at closing. As of October 1, 2002, we had borrowings of \$11.2 million on the revolver and \$3.4 million assigned to standby letters of credit related to our workers' compensation insurance policy. The remaining \$5.4 million would be available to be used for working capital and capital expenditures in the absence of the defaults existing under the Credit Agreement discussed below. 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.

Our reduced sales during the first thirty-nine weeks of 2002 contributed to our operating losses and a significant reduction in our cash flow. We have continued to be out of compliance with the financial ratio covenants required by our Credit Agreement as of October 1, 2002, which has resulted in the lenders' refusal to make further advances of the revolving portion of the Credit Agreement, requiring us to operate based on our available cash flow since May 2002. We have taken a number of actions to conserve and manage our cash, including withholding two principal payments under the Credit Agreement that were due July 2, 2002 and October 1, 2002 in the amount of \$1.3 million. We also have unpaid accrued interest of \$1.2 million as of October 1, 2002.

We have been in regular contact with our lenders regarding the current condition of the Company's business and existing covenant and payment defaults, and we have retained a financial restructuring advisor acceptable to our lenders to evaluate the Company, assist us in addressing business issues resulting from our reduced cash flows and in providing information to our lenders.

We have entered into a Limited Forbearance Agreement (the "Agreement") with our lenders pursuant to which they have agreed not to exercise their remedies under the Credit Agreement in response to the existing defaults for a period ending December 31, 2002. The Agreement contains disclosures of the existing defaults under the Credit Agreement and general releases of any claims that we might have against the lenders, and requires expanded and more frequent reporting to the lenders, compliance with new cash flow and cash balance targets, as well as continuing compliance with the provisions of the Credit Agreement that are not the subject of existing defaults, weekly partial interest payments in the amount of \$50,000, accrual of interest under the Credit Agreement at the default rate and the submission to the lenders of a business plan for fiscal year 2003. We also agreed that we would not terminate, amend, modify or supplement our agreement with Corporate Revitalization Partners, our financial advisers, without the prior consent of the lenders.

The lenders' agreement to forbear terminates automatically on December 31, 2002, and is subject to earlier termination by the lenders if we fail to comply with the Agreement, if a bankruptcy petition is filed by or against us, if an event occurs which would have a material adverse effect on us, or if additional defaults occur under the Credit Agreement. Upon any termination of the Agreement, the lenders could seek to exercise their remedies under the Credit Agreement, including foreclosing upon and selling or



otherwise disposing of our assets which secure our obligations under the Credit Agreement, any of which could significantly and negatively impact our financial condition and operating results. If the lenders seek to exercise their remedies under the Credit Agreement, we will be forced to consider filing a petition for relief in United States Bankruptcy Court. Because of the existing defaults and the short-term nature of the Agreement, our debt under the Credit Agreement is reflected as a current liability on our balance sheet.

Another action we have taken to conserve and manage cash, has been to withhold payments due pursuant to an interest swap agreement maintained by us pursuant to the Credit Agreement. As a result, the instrument was terminated on September 12, 2002 with a settlement value of \$486,000 and unpaid interest amounts of \$153,000 for a total market quotation amount of \$639,000, which is reflected on our balance sheet as a current liability.

During fiscal 2002, we withheld legally required minimum funding payments due to our noncontributory defined benefit pension plan (the "Plan") totaling \$764. We are liable for the contributions to the Plan to meet the minimum funding requirements. We will be liable for interest and, in some instances, excise taxes on the withheld payments. Our limited available cash flow is expected to continue to adversely affect our ability to meet our funding obligations to the Plan during the remainder of 2002 and into 2003. Our failure to make the payments necessary to satisfy the minimum funding requirements for the Plan has been reported to the Pension Benefit Guaranty Corporation ("PBGC"), but no action has been taken by the PBGC at this time. If efforts to improve our cash flow to a level that will allow the required payments to the Plan to be made are not successful, the PBGC may take various statutorily prescribed actions to protect the Plan's assets and benefits, including asserting a statutory lien against our property, taking control of and operating the Plan, terminating the Plan and pursuing legal action against us to recover the Plan's funding deficiency. In addition to the PBGC, the Plan, the Plan fiduciaries and/or participants and beneficiaries may sue to compel us to meet the Plan's minimum funding requirements. If the Plan is terminated all benefits will become immediately payable, the specific amount of which will depend upon the applicable actuarial assumptions for the Plan. The Plan termination liability was estimated to be \$9,100 as of January 1, 2002. Based on financial market developments during 2002, we believe that the Plan's termination liability has increased since January 1, 2002.

We operate thirty-seven (37) restaurants which were subleased from Kmart Corporation pursuant to a Master Sublease. Kmart filed a Chapter 11 bankruptcy proceeding in January, 2002 and has subsequently rejected one (1) of our ground subleases and ten (10) of our full premise subleases and had announced its intent to reject the Master Sublease as to an additional twenty-two (22) properties subject to full premise subleases. We have signed new leases with the landlords on the ten (10) full premise lease properties that were rejected, and we were able to terminate our obligation to continue paying rent on three closed locations. The landlord of the rejected ground lease is claiming that the "rejection" of the lease by Kmart terminated our sublease. We believe the prior actions by the landlord created an "acceptance" of our sublease and that we will prevail in court.

We have been made aware that Kmart has entered into an agreement with the ultimate owners of the properties subject to the Master Sublease that would have the potential of permitting those parties to become the direct landlords of the Company under the terms of the Company's Master Sublease with Kmart. Upon information and belief, this agreement was entered into in the course of Kmart's bankruptcy proceedings and after Kmart had defaulted on its payment obligations to this landlord under its master lease. We are not a party to the recent agreements and negotiations between Kmart and the other parties to its master lease. We will strenuously defend our legal rights with respect to the Master Sublease, and our rights under the Bankruptcy Code, and will resist any agreement that discriminates unfairly against us as compared to the treatment afforded other Kmart sublessees or that alters or extinguishes the economic benefits we are entitled to derive under the Master Sublease as a whole.

A hearing in the Kmart bankruptcy proceeding is scheduled in December 2002 to consider a motion by Kmart, supported by the owners of the affected properties, to assign the Master Sublease to them. We intend to oppose this motion, but are not able to provide assurance as to its outcome. Possible outcomes may include (i) that we will continue to be subject to the Master Sublease, and accordingly will be obligated to pay rent on all of the remaining premises subject to the Master Sublease, or (ii) that the Master Sublease will be deemed to have terminated in September 2002 and we consequently will no longer have the benefit, or the burden, of a written long-term lease agreement securing our right to occupy these properties. In the latter case, we would cease paying rent on closed stores and would enter into negotiations to secure long-term leases on the remaining profitable stores. While we cannot give any assurance that such leases can be obtained, we believe that new leases could likely be obtained on the remaining profitable stores at fair market rents substantially less than apply under the Master Sublease. The loss of possession of some of these stores would have a material adverse effect on us.

In order to limit our exposure to any conflicting claims regarding the proper payment of rent and to assist in managing and conserving our cash, we have not paid the rent due on the 22 restaurants as to which the Master Sublease has not been formally rejected that was due on July 1, August 1, September 1, October 1, and November 1, 2002 of approximately \$.3 million per month. Given the uncertainties associated with the Master Sublease, we are awaiting discussions with the affected parties to establish reasonable assurance that we are paying the appropriate amounts to the proper parties. The failure to pay rent allows the landlord to declare the Master Sublease in default, and, if it so elects, to seek to

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

recover unpaid rent from us, and to evict us from the affected premises if the unpaid rent remains unpaid after notice of default. We cannot provide assurance that the withholding of rent payments will not result in adverse action by the landlord as to some or all of the affected stores, which could have a material adverse effect on us.

Kmart has announced that as part of its plan of reorganization it will be closing a significant number of its stores. We have reviewed our locations to determine whether any adverse effect on our restaurants might occur as the result of the closure of nearby Kmart stores. We believe that fewer than five of our profitable stores are proximate to Kmart stores. While the closure of the nearby Kmart store could have a material negative impact on a restaurant's customer traffic, we do not believe we are subject to a risk of a material adverse change in our business, as a whole, based on the limited information regarding store closings currently available from Kmart and our review of operations at these restaurants.

We are monitoring these conditions closely and, with the assistance of our advisors, are implementing, or continuing, a number of initiatives to increase our revenues and cash flow from operations. In addition, with our advisors, we will be working to develop business plans that will support reaching a long-term agreement with our lenders, renegotiating leases where necessary, including the remaining subleases with Kmart, and identifying other areas for cost reduction. Because of the difficulties resulting from our reduced cash flow and the unavailability of revolving credit advances from our lenders, our financial condition and liquidity are expected to be very sensitive to any further adverse developments in our business, including further declines in customer counts, further restrictions of credit or other adverse actions by our creditors, adverse developments in the economy that impact our customers, or an inability to realize substantial cost reductions, including rent reductions. Our management, in conjunction with our advisors and Board of Directors, is establishing priorities to address our most pressing needs. Material negative developments in any one or a combination of these areas could require us to consider a Chapter 11 filing in United States Bankruptcy Court.

### Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") recently issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146). SFAS No. 146 requires all restructurings initiated after December 31, 2002 to be recorded when they are incurred and can be measured at fair value, with the recorded liability subsequently

20

---

adjusted for changes in estimated cash flows. The Company is currently assessing the impact of SFAS No. 146 on its consolidated financial statements.

The FASB recently issued SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statements No. 13, and Technical Corrections. SFAS No. 145 rescinds SFAS No. 4 and establishes new requirements for the accounting and presentation of gains and losses from Extinguishment of Debt. As a result, gains and losses should be classified as extraordinary only if they meet criteria set forth in APB 30. Applying APB 30 will distinguish transactions that are part of an entity's routine or recurring operations from those that are unusual or infrequent or that meet the criteria for classification as an extraordinary item. SFAS No. 44 was rescinded as the transitions to the Motor Carrier Act of 180 are completed. SFAS No. 64 amended SFAS No. 4 and is no longer necessary. SFAS No. 13 was amended to require sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for transactions occurring after May 15, 2002, with earlier adoption encouraged. The Company is currently assessing the impact of SFAS No. 145 on its consolidated financial statement.

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations (SFAS No. 143). SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement or tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Company also records a corresponding asset which is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company is required to adopt SFAS No. 143 on January 1, 2003 and does not expect this standard to have a material impact on its consolidated financial statements taken as a whole.

### Critical Accounting Policies

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

Certain of the policies require us to make significant and subjective estimates and assumptions which are sensitive to deviations of actual results from our assumptions. In particular, we make estimates regarding future undiscounted cash flows from the use of long-lived assets in

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

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.

We have 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.

We have 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 different than assumed by us, based on our ability to attract customers and compete in the marketplace and if operating costs are different than what we projected.

21

---

### Forward-Looking Statements.

The discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations includes forward-looking statements regarding our present plans, which involve a number of risks and uncertainties. The actual results of the future events described in such forward-looking statements could differ materially from those stated in such forward-looking statements. Among the factors that could cause actual results to differ materially are: adverse conditions in the restaurant industry and other competitive factors, governmental regulation, pending and possible future litigation, seasonality of business, loss of material suppliers or increases in the costs of raw materials used in our food products, termination of key franchise and/or license agreements, actions by our lenders and creditors as well as other risks and uncertainties disclosed in periodic reports on Form 10-K and Form 10-Q filed with the Securities and Exchange Commission.

#### 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 used an interest rate swap to manage the cash flow risk on \$20 million of our variable rate debt until the termination of this instrument on September 12, 2002 due to an Event of Default for non-payment of interest. 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.

#### Item 4. Controls and Procedures

Our Chief Executive Officer and Principal Financial Officer have concluded, based on their evaluation within 90 days of the filing date of this report, that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the previously mentioned evaluation.

## PART II. OTHER INFORMATION

Items 1, 2, 4 and 5 are not applicable and have been intentionally omitted.

#### Item 3. Defaults Upon Senior Securities

(a) The Company is party to a \$55 million Revolving Credit and Term Loan Agreement (Credit Agreement) with various banks and lenders with an outstanding balance as of October 1, 2002 of \$41.9 million. 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

22

addition, there are certain restrictions on the payment of dividends and incurrence of additional indebtedness. The Company's reduced same-store sales during the first thirty-nine weeks of 2002 have caused the Company to incur operating losses and a significant reduction in its cash flow. The Company has continued to be out of compliance with the financial ratio covenants required by its Credit Agreement as of October 1, 2002, which has resulted in the lenders' refusal to make further advances of the revolving portion of the Credit Agreement, requiring the Company to operate based on its available cash flow during this period. The Company has taken a number of actions to conserve and manage its cash, including withholding two principal payments of \$1,275 each under the Credit Agreement that were due July 2, 2002 and October 1, 2002. The Company also had unpaid accrued interest of \$1,188 as of October 1, 2002.

(b) Not Applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

1. Exhibit 10.1: Forbearance Agreement
2. Exhibit 99: Certification

(b) Reports on Form 8-K

A report on Form 8-K was filed on September 30, 2002 with respect to the resignation of Craig Miller as President and Chief Executive Officer, the hiring of William Snyder as Chief Restructuring Officer and Acting Chief Executive Officer and that the Company had reached a preliminary understanding with its lender group.

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: November 13, 2002

FURR'S RESTAURANT GROUP, INC.

/s/ William K. Snyder

William K. Snyder  
Interim Chief Executive Officer  
(Chief Executive Officer)

/s/ Nancy A. Ellefson

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

**CERTIFICATION**

**Pursuant to Section 302 of the Sarbanes Oxley Act of 2002**

I, William K. Snyder, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Furr's Restaurant Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I (herein the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a. designed such internal controls to ensure that material information relating to the registrant, including its consolidated subsidiaries, (collectively the "Company") is made known to the Certifying Officers by others within the Company, particularly during the period in which this quarterly report is being prepared;
  - b. evaluated the effectiveness of the registrant's internal controls as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c. presented in this quarterly report the conclusions of the Certifying Officers about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's Certifying Officers have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a. all significant deficiencies (if any) in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's Certifying Officers have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ William K. Snyder  
William K. Snyder  
Interim Chief Executive Officer

See also the certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002, which is also attached to this report.

---

### CERTIFICATION

#### Pursuant to Section 302 of the Sarbanes Oxley Act of 2002

I, Nancy A. Ellefson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Furr's Restaurant Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I (herein the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

## Edgar Filing: FURRS RESTAURANT GROUP INC - Form 10-Q

- a. designed such internal controls to ensure that material information relating to the registrant, including its consolidated subsidiaries, (collectively the "Company") is made known to the Certifying Officers by others within the Company, particularly during the period in which this quarterly report is being prepared;
  - b. evaluated the effectiveness of the registrant's internal controls as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c. presented in this quarterly report the conclusions of the Certifying Officers about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's Certifying Officers have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
- a. all significant deficiencies (if any) in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's Certifying Officers have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ Nancy A. Ellefson  
Nancy A. Ellefson  
Chief Accounting Officer

See also the certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002, which is also attached to this report.