

HILCO REAL ESTATE, LLC

**Retail and Restaurant Lease Restructuring
Moderator: Mary Jo Larson, Franchise Times
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10:00 am CT**

Operator: Good day and welcome to the Hilco Real Estate Franchise Times conference call on restaurant leasing restructuring. Today's conference is being recorded.

At this time I would like to turn the conference over to Mary Jo Larson with Franchise Times for opening comments. Miss Larson.

Mary Jo Larson: Thanks, David. Good morning; I'd like to welcome you to today's teleconference. As you may know, Franchise Times is the only publication that targets both franchisers and multiunit restaurants franchisees.

We reach more than 23,000 business owners and senior executives most of whom work in the food service sector. We also publish the Restaurant Finance Monitor, a publication that highlights finance and development topics for senior executives.

Franchise Times and the Restaurant Finance Monitor are also affiliated with the Restaurant Finance and Development Conference, the largest industry event exclusively focused on the financial side of the restaurant business. This year the conference will be held Nov. 8-10 at the Bellagio Hotel in Las Vegas and we hope you will join us.

So much for my commercial message.. It's time to learn more about restructuring and renewing restaurant leases, about how to save your enterprise substantial amounts of money and about how to take advantage of the current glut of retail real estate on the market, It's also a chance to try to enhance and expand your operation.

With me today are Neil Aaronson, CEO of Hilco Real Estate and Greg Apter, president of Hilco. Hilco is the largest provider of real estate restructuring and renewal services in North America. In 2009 alone Hilco was able to save clients in excess of \$150 million on nearly 8,000 leases.

The majority of savings was in the retail sector with a large percentage in food service space. Hilco Real Estate is a unit of Hilco, a global leader in valuing and monetizing business assets including inventory, real estate, machinery and equipment, accounts receivable and intellectual property.

I will be asking Neil and Greg a series of questions roughly following an agenda that we sent to all call participants along with a dial-in number and access code for today's call. We have about 45 minutes to cover the agenda.

I know you will come away with a wealth of information that you can use to help mitigate lease costs, enhance the non-economic benefits we save from landlords and also take advantage of opportunities to capitalize on today's very soft commercial real estate market.

We have approximately 300 people on this call: restaurant and retail owners; operators and lenders; business turnaround specialists; landlords; media reporters; and even a few of Hilco's competitors. I am sure there will be many interesting questions resulting from what Neil and Greg have to share with us.

We'll leave 15 minutes or more at the end for your questions.

When we take questions, the operator will announce your name, open your line and you then will ask Neil or Greg your question. Neil we're going to start with you. Please give us Hilco's overview of the retail and restaurant real estate landscape.

Neil Aaronson: Certainly, Mary Jo. First off, all areas of retail and restaurant real estate have suffered over the past two-plus years. Now it is important to point out, however, that the disparity in real estate value or rental and lease value is greatly separated by the real estate quality.

There's a big difference if you have real quality real estate versus if you have real estate in secondary and tertiary markets. As a general matter, values have not been materially affected on the A-quality real estate.

There was a time during 2008 and in the beginning of 2009 when virtually all retail and restaurant expansion had screeched to a halt. Now this is the case for virtually all the real estate. However, from what we've seen over about the past 9 to 12 months, to the extent there has been any strategic expansion by retailers or restaurant operators, those A and A-plus sites have been the first to be leased or sold. And much of the time [the values of these transactions are] not materially worse than what previously existed before the recession started. This development is really a direct result of the quality of the real estate.

The quality of the property isn't the only variable that can impact real estate and/or a tenant's ability to secure lower rent or receive landlord contribution in the lease negotiation. There are many other variables that will impact the success of this endeavor.

It is those variables that we will be discussing in much greater detail on this call and they are the primary drivers of the successful lease restructuring effort. Now, putting aside the A and A-plus

real estate, most retail and restaurant real estate has been and/or will be severely impacted by the recession.

Currently, significant excess supply exists in the market. Expansion into or the absorption of much of this space [is expected] to be very, very slow. As a result, the values of the real estate or the rents have been materially impacted and we expect them to continue [in this direction] for the foreseeable future.

Now, regarding most ancillary real estate in tertiary markets or worse, there's really no relevant timeline to project when these properties will recapture their previous value, even though the pace of vacancy rates slowed in the fourth quarter of 2009 and we expect [the same in] January 2010.

The vacancy rates are still increasing for both retail and restaurant real estate. So I throw an analogy here to what's happening in the overall monthly unemployment reports. For many, many months on end, unemployment was dramatically increasing and a number of people signing up for the unemployment rolls was dramatically increasing every month.

But then, over the latter half of 2009, the rate at which people were signing up for the unemployment rolls started to slow. However, more people were signing up for unemployment than were actually finding jobs. Similarly, that's what's happening in the retail and restaurant real estate space.

The pace at which vacancy rates are increasing has slowed—that's the good news. The bad news, however, is that vacancy rates are still increasing [with] no sign of abatement in sight. So, understand the causes of this real estate deterioration: increase in vacancy rates; decrease in values; and decrease in market rents.

We must first understand what is going on in the industry as a whole. Both in the retail and restaurant industries, we've experienced a dramatic shift in demand. Economic strain due primarily to wealth deterioration has caused lower consumer spending.

And that's hard to generalize because there are certain segments of the industry that have performed as well or better than they did even prior to the recession and some that have veered dramatically worse. As examples in retail, anything that's either discretionary or high-end spending has suffered dramatically.

And in the restaurant space, casual dining and the white table cloth establishments have suffered much worse than quick service restaurants [QSR] or fast casual. QSR and fast casual have generally performed OK. Restaurants, in particular, had been suffering. In terms of timing, their suffering is impacting their overall business operations and is lagging behind that of retail.

And if spending habits continue to change, it is our expectation that strain likely will continue in the restaurant sector and the number of distressed restaurant companies will increase throughout 2010. By way of example, in the past two weeks alone we have had restructuring conversations with five restaurant companies.

So all of these factors in the industry have caused the demand for the real estate to be curtailed. And, as a result, the upside is that there is significant opportunity for companies that are in expansion mode to pick up real estate at very attractive prices.

[This is true] whether through acquisition or through an expansion plan via leasing real estate at very attractive rates. We're going to discuss this topic further later in the phone call. Lastly, we will talk about lease restructuring and what impacts the success of the lease restructuring as well as the success and the impact of the value of restaurant real estate.

It is very important to note that there are different concerns for restaurants than there are for retailers. Typically, the restaurant loans made to restaurant companies are cash flow loans while loans made to retailers are typically collateralized by hard assets.

This is a material difference and will impact the way landlords respond to your negotiation and will impact the way businesses have to approach their negotiations with their lenders and landlords.

Mary Jo Larson: And that'll be interesting to follow up on that, Neil, later and what are those differences.

Neil Aaronson: Absolutely.

Mary Jo Larson: Greg, you're up next. In the context of the real estate market as Neil described, let's talk about existing lease restructuring. What's possible and how to get it done?

I understand the place to begin is with an assessment of the lease portfolio and each lease within it. What exactly are you looking for? And what is your thought process around that?

Greg Apter: Thanks, Mary Jo. The quick summary [of] what we're looking to do is to review all the relevant information that can affect how a [lease negotiating] process should be conducted and, ultimately, the level of success that's likely to be achieved.

More specifically, we need to understand the tenant's applicable set of facts and circumstances, which, when utilized properly, are going to have the most impact. And that applies whether it's to renegotiate or terminate a lease in midterm, whether it's to renew an existing lease or whether it's to acquire a space through a bankruptcy, or, I should say, an acquisition.

It's all about how you achieve the best economic and non-economic terms through your efforts to secure space or to preserve existing space. And it's probably worth going off to the side a little bit

here and mention something else. There has been a lot of recent conversation relating to the quote/unquote "closing of the window."

The window of opportunity to restructure is a critical take-away from this conversation. Throughout 2007 and 2008, landlords were receptive to many tenant requests notwithstanding the circumstance surrounding that tenant. However, those times have passed. The window, contrary to what some of the so-called experts claim, has all but closed with respect to lease restructuring. The window where a tenant can call a landlord and try to get any savings that they feel like getting has long since closed. If it was ever really open in the first place [considering] the deeply strained economy and, specifically, the numerous tenant liquidations and the freeze of the capital markets.

All of those factors created essentially the fear necessary to get restructuring done. Landlords didn't apply rational thought to whether working with a tenant made sense. They just did it in certain circumstances.

What I think for the purposes of this call is the final critical piece is that the real window of opportunity always has and always will exist so long as [there is] the right due diligence, so long as [there is] the appropriate use of the facts to create leverage; that is the buzzword, leverage.

Through the appropriate use of all the available leverage, there will continue to be a significant opportunity to restructure as well as negotiate advantageous deals going forward. And ,again, that applies across all situations: distressed companies in bankruptcy, distress companies that are looking to improve their current situation and healthy companies that may want to improve on an asset management level.

Mary Jo Larson: Greg, what do you do with the information in the portfolio assessment? And you were talking a little bit about leverage there too.

Greg Apter: It all starts with an in-depth portfolio review. This would typically include compilation and review of all the lease-specific information whether it's portfolio wide or a lease-by-lease basis. Unit level financial information, indeed, all of that information, gets put into a spreadsheet.

We also put a review of the company's corporate financial data together in a master spreadsheet. We create a model. We work out different scenarios and then take that information and meet with management so they can truly understand the facts surrounding the initiative.

We discuss their goals and perhaps, most importantly, their specific message and negotiating style to be used in dealing with the landlords. It's an important side note that some tenants have a great fear that when we, or others, or even the tenants themselves talk to landlords, there's going to be damage to the tenant-landlord relationship.

The important point to make here is that when we or anyone else take on an assignment, the message must be crafted properly and there must be truth behind it. There is communication behind this message. There is sharing.

Not only will there be no harm to a relationship but, typically, it helps facilitate a stronger partnership between the tenants and the landlord. What is critical, however, is how you want to deliver a message, why you want to deliver a message, what should you say, what should you not say? It's the intuitiveness that is important to understand before you start talking to landlords.

Mary Jo Larson: What are the measures of probable success? And how is that information used in such strategies? What information are you using?

Greg Apter: What best determines success is really the effective use of what I discussed before, which is leverage. Carefully crafting a message and using it appropriately along with the necessity of delivering information and materials many times to the landlord, that is the key.

You can talk to a landlord but, ultimately, if you're trying to get them to renegotiate, for example, a midterm lease, well they've already [gone through this] with you. You [and the landlord] sat across the table and you worked out a deal that was your promise to pay and the landlord's promise to deliver whatever product they're delivering to you.

So if we're in a midstream renegotiation, the landlord's going to feel a little bit quote/unquote "distasteful." Why are you renegotiating with me? Why should I do this? We struck a deal. Why am I compelled to work with you? And the answer to that is that's the art of the deal.

Here's your message. Here's why we need help. So you can deliver that. Here's not only the verbal piece, it's also the written piece. You may have to provide financial information. What do you need to provide? Or it could be our corporate-level financial information.

Here's our unit-level financial information. Sometimes it makes sense to deliver it, sometimes it doesn't. What's going to get you the optimum results in any negotiation is a balance between the art and the science.

The science is having your information and your spreadsheet, knowing what you need to accomplish on a site specific basis and knowing what message you're comfortable delivering. Know, too, that the landlord will be interested in getting background information to justify why they should be working with you.

Have answers to those questions ready in your own mind, before they're ever asked by the landlord, so that you can give them information they need. But here's what's key. The answers should be formulated to get you the best results for the circumstances you're in.

Whether it's a bankrupt company, a stress company or a healthy company, each will offer its own answers. For a healthy company, what seems to be quote/unquote "difficult" these days is a restructuring.

Let's say you are a healthy company with 10 years to go on a lease, no apparent problems, you report sales and the landlord understands everything, You're not going to have much success on a renegotiation.

But its' different if you craft a message when you've got only a couple of years to go on a lease and you know that the landlord's got a loan on the property. And you're willing to investigate into options to make the landlord nervous that you're contemplating moving or that you are looking at alternative sites.

There are ways to make landlords nervous: renewals and possible relocations; or possibly shutting down sites where it can impact the landlord significantly. And it really all boils down to a large set of variables that you can use on your behalf to try to make the landlord understand that you've got other options.

Mary Jo Larson: You mentioned it's an art and a science, Greg. And we were talking about the science of the deal: having all your documents prepared and knowing what the questions are going to be before they're asked.

Talk about the art part of it a little bit. And is that the tactics, the tips to avoid when you're in the negotiating process? Can you give us some of those? What should you avoid doing?

Greg Apter: Well that's an interesting question because the way to think about the restructuring process [is] you really only have one good shot at this. If you're going to go out as a tenant on your own and say, hey, I need some help. [But] you show them a unit level financial statement that shows you're making a lot of money.

And if you then show them corporate financials that show that you're doing well, you've blown your opportunity whether you have two years to go or 10 years to go on a lease.

So the science is easy. The science is basic deep due diligence, understanding your obligations to the landlord, their obligations to you. What does the lease say? What is your lease term? What do the unit level financials say? What are your corporate level financials?

The more critical piece of any restructuring is the art. And the art is what to say, when to say it, how to say it, when not to say something, and putting yourself in the landlord's shoes so that you know what would make you nervous if you were sitting on the other side.

It's about listening to the landlord [to know] if he or she is telling you information that you can use to your advantage. You need to be calm enough and relaxed enough to [be prepared] to use that kind of information.

The process is such that you control the flow and that's the art.

The message, that's the art. Listening to the landlord, that's the art. Let's say that you've decided that you've conveyed a message that this location isn't necessarily struggling.

There's not much you can do there unless you can bring new leverage into the discussion and get the landlord to get off of that point about the location not struggling. Because once a landlord forms a conclusion there's really nothing that you're going to get done.

Mary Jo Larson: Just delving into the art a little bit more. Can you use the same negotiating strategy techniques for a new lease when you're renegotiating an existing lease? Can they be the same or are there differences there?

Greg Apter: The general concept is the same. I think one important caveat to flag is when you're restructuring an existing lease you really need to focus primarily on the economic piece and a fairly narrow piece of the non-economic.

Unless, of course, you're in bankruptcy, which [requires] a slightly different approach. But when you're a healthy company or you're even a stressed company, you have negotiated all the non-economics as part of [your existing lease].

This involves the use, the assignment, continuous operations, radius restrictions, things of that sort. It's hard to start from the beginning and renegotiate that lease when you are renegotiating an existing deal—for a new location, be that as it may.

As for leverage, the same essence still applies. What is going to make the landlord interested in wanting to cooperate? What deal can be reached so that the landlord feels like it's in their best interests to want to work with you and sign up?

Now the important difference between a new lease and existing lease really is as it relates to the flexibility and the information that the landlord knows about the site. If I'm negotiating a new lease on behalf of a client what do I want to accomplish?

Number one, let's be careful about the term of the lease. Is five years the right term? Is 10 years the right term? The longer the term, the less flexibility there is on the use and assignment and there are no kick-outs if I have to report sales.

The more inflexibility, the more information that the landlord knows of my performance on that site. Any compulsion that I have to not only give them unit level information but corporate level information, that's going to cause me more and more problems later.

We represent several different restaurant chains and retailers who report sales on a year-level basis but it's more than just sales. Restaurants are often perceived as a stand-alone business at a particular site. So once the landlord realizes that the sales are X, they can compare them to the portfolio for the company and it might be twice as much as another location or 50 percent more than another location. [This means] they're going to be less inclined to cooperate. So what's critical on the up-front piece is that you've got to stick to a disciplined approach.

You've got to try to retain as much flexibility as possible. Everybody wants to expand. Everybody wants to grow the top line. But at the end it's more about the bottom line than it is the top.

Don't get caught up in having gross revenue of \$100 million and net income of zero dollars when you might be able to get top-line revenue of \$75 million and a net income of \$5 million or \$7 million.

That's where a company gets successful, and once you sign up 10-,15- 20-year leases you're stuck. It's not that easy to just renegotiate them. You have to start the whole process again and justify why there should be a change.

Mary Jo Larson: I think that's a good segway for Neil to discuss the trouble in retailing and retail real estate and why is that a potential boon to owners and operators.

Neil Aaronson: I think that's sort of the upside of all of this conversation. And, taking a step back, it's important to note what happened during most of the 2000s: the economy was going extremely well; the world was rosy; and restaurant chains were expanding rapidly. Retailers were expanding rapidly. It was interesting, from a lease restructuring company's perspective, that there were tremendous opportunities in lease designation rights and subleases.

It was like every time there was a bankruptcy or a situation where a sublease was available, it became, on some levels, something that we looked forward to dramatically, although we're not trying to be the grim reaper.

It was like a desire on our part to say we could take advantage of these bankruptcies dramatically and make a lot of money in lease designation rights and subleases. And we wanted more and more of those opportunities. This is what's happened since the end of 2008.

The quantity of bankruptcies and restructurings has increased dramatically. However, due to the fact that lease rates have dropped so dramatically in conjunction with the fact that the number of retailers and restaurant companies that are expanding has dropped so dramatically, it has made the market for lease designation rights and subleasing much smaller.

On some levels it was almost nonexistent last year, which took [away] a major part of our business and some of our competitor's business and focused it instead in a different direction because that lease designation rights component wasn't there any more. To address your question more specifically, Mary Jo:

Why does that create an opportunity for retailers and restaurant companies? Well, now is a tremendous opportunity. Because there is so little competition for the vacant space, means that any company that is in a position to expand, will never have a better time to do so.

Because the wealth of opportunities to either buy/rent restaurant real estate or lease restaurant real estate at dramatically lower values than what have been seen in the past several years is abundant.

In the last two weeks alone we've been speaking with five different restaurant companies. The bad news is four of them have been on the side where they're starting to become more distressed than they had hoped to be. They were hoping to turn operations around in 2009 and it's not working out. Now there are lease restructuring opportunities that are clearly available to them.

On the other hand, there is one company we're talking to that is clearly well capitalized, has a strong balance sheet, a full wall contribution of its existing stores and its overall margin is hanging in there, not necessarily getting much better but hanging in there. As a result, we're now talking to that company about dramatic expansion opportunities because of the wealth of lease designation opportunities and subleasing that is available in the market.

That company is going to have tremendous success and the pick of the litter. And, our expectation is that there will be a lot of distress continuing in the restaurant space that the well-capitalized companies will really see the long-term opportunity to take advantage of. They will begin to start participating in the great expansion opportunities that are before them.

Greg Apter: And I want to add one little piece, which you can call it a pitfall as you referenced earlier, Mary Jo, but also a piece of what Neil just answered. It's discipline. Be disciplined in what you're trying to do and in why you're trying to do it.

Growth is important, whether it's through new seemingly terrific opportunities or in trying to pull something existing together. Mistakes usually create a more significant impact than your good decisions. If you have two locations and one is performing well and one is performing very poorly,

it's amazing how that poor one drags you down. You have to have a high level of success. If you have risk out there you've got to try to mitigate that risk. You've got to try to control your downside and try not to cap your ops; that is really an important point to be made here.

Neil Aaronson: Mary Jo, there's the double-edged sword as Greg mentioned. You've got to be very careful about taking on too much risk and expanding too quickly.

I think if you look back, revisionist history will probably dictate that the rapid expansion that most restaurant companies took in the middle 2000s resulted in many mistakes being made. This current period of time, however, is very different than that previous period.

Because in the rapid expansion of 2005, 2006, 2007, people were expanding into real estate markets and into competitive industry markets that were incredibly challenged. There was more competition every day, higher lease rates, and higher property values if you wanted to own your property.

That contributed to the riskiness of the expansion. In today's market, however, we see the great opportunity to actually expand in a much safer dynamic. Competition is contracting. Real estate values are declining and lease values are declining.

Again, taking Greg's point seriously into consideration and it is a very material one. There still exists a much greater opportunity to expand in a less risky way if you have the right balance sheet to do so.

Mary Jo Larson: But there has to be discipline as Greg mentioned and I think that was a great point. We've covered a lot of ground.

And I think [some of what you have said] could be overwhelming to some people. Some on our call may be comfortable with what you're saying. Others may not understand this point if they're good operators but not necessarily a great real estate expert.

Did they conduct their lease negotiations with discipline? What are the pros and cons of using an outside expert to negotiate on your behalf if you're not an expert of lease negotiations yourself?

Neil Aaronson: I'll take this one and Greg will chime in. You pointed out one of the important factors in the pros of using an expert, which I can't say uniformly for all companies. Almost all of the clients have real estate departments with real estate experts who have been extremely successful over a long period of time in their restaurant expansion strategy and in their overall management of the portfolio of restaurant spaces.

They've been very good at it, and history has proven they've been very good at it. That is until a recessionary environment hits like this [current one] or a particular distress hits or circumstances change within that restaurant company.

Rarely is it the case that that real estate department within that company is really focused on major renegotiations. Again, as Greg pointed out earlier, it's very important for them to maintain very good relationships with their landlords.

It's very important to maintain a relationship with their landlords where the landlord expects and what, hopefully for them, is that there will be a restaurant company in that landlord's space for many, many years to come.

Now what we are expert at, and others in our field, [is as] people who specialize in nothing but lease restructurings. This is what we do for a living. And what we've mastered or we've become

very good at is the art of renegotiating a lease and playing that middle man's position to a number of things.

Number one, we understand where the leverage exists and doesn't exist. Number two, because we renegotiate so many leases on an annual basis we are in contact with a vast majority of landlords so we understand what are and are not the landlord's hot buttons as it relates to lease restructurings.

We understand what factors are likely to be successful with particular landlords, what factors aren't like to be successful with particular landlords. Most important, is that both the client or the retailer or the restaurant company and the landlord actually get something out of this.

In many cases these restructurings can be good events for both the landlord and our clients, be it a restaurant company or retailer. We understand what it is that a landlord is looking for, what can actually help them, and that they not look at renegotiating as a bad thing.

They're actually going to get things out of a renegotiation that are helpful to them. So from our perspective, as experts who do this every day, there are tremendous advantages to knowing all of those things compared with a general real estate department, as competent and well trained in real estate as they may be.

This is not what a general real estate department may do every day but [it is] what we do every day. And so those factors really help to get a more successful renegotiation. One other factor that I think is very important is that there are certain times where, in order to negotiate successfully, you need to be very firm in negotiation tactics. You need to understand the leverage and then the conversations ultimately, will yield a good result. It will get tense for a period of time and that's something that we have become accustomed to.

And we're good at handling those situations and positioning the companies, our clients, in the best light in those situations. So that at the end of the day, when the renegotiation is over, the client and the landlord still have their wonderful relationship.

And the renegotiated lease, which will likely have many, many years on it, will be one in which the company and the landlord are cordial, cooperative and collaborative. So they can both be successful on a go-forward basis.

Greg Apter: Right, and now I'll chime in and just add a couple more points, [When], we [work] on behalf of a company, be it through expansion or through contraction or through pure restructuring and renegotiation the introduction of a third party like Hilco shifts the discussions to a different level. I'll use this as an example. We are representing a stressed or distressed company and being able to communicate that we have not been hired in this circumstance specifically as a restructuring adviser shifts the thinking of a landlord.

It makes them think, well now, this is a little different. I can't call (Jim) or (Barbara) or whomever who is representing the company as it's vice president or director of real estate and find out what's going on. Now I've got to deal with these folks who are going to lay out the facts.

And, clearly, this is at a level where I need to be responsive. I need to understand what's going on. Once [the landlords] think like that we have them where you want them, which is in a way where they're going to be listening. We know they're going to be looking for information.

But [it is] information that we are going to provide to them because we know the questions they're going to ask before they ask them. And, in some respects, the best word to use is indifference when it comes to this.

If you are representing a troubled retailer or restaurant chain and you're in a bankruptcy, the ability to go to a landlord and say, well look, here are the way the facts are laid out. And if you don't want to cooperate that's fine. I certainly understand.

But please understand that I have no choice but to do this. And it's up to you. You're the one that holds the power here because you can say yes or no to me. If you say no and you'd rather have your site back that's certainly your prerogative and I wish you the best of luck.

And it is that casual indifference, which is all part of the art that I was describing earlier, that really gets the landlord's attention because they know that you're not married to their location.

And it's that indifference that creates the leverage that gets you where you need to be. So it's the use of that artful language. It's the use of timing. It's waiting for landlords to give the information. That's really is a lot of the process, and the benefit of getting us involved.

It's knowing exactly what to say, when to say it and the [negotiating] history because we've dealt with some of these landlords on literally thousands of sites. So they know who we are and that, we take on accounts only when we know that there's an opportunity to help a company.

And it's necessary to help a company. There's an automatic credibility to having us around because we won't just say yes to anybody. As a matter of fact, we probably turned down as many accounts last year as we accepted and worked on.

Because you have to know where your leverage is and there's almost always some leverage that's on any account. The question is how much and how are we going to go about trying to secure the results.

Mary Jo Larson: If I'm a restaurant operator and I have enough of a challenge just operating my restaurant business and I don't really know where my leverage is and I don't understand when to be indifferent or more [or less] emotionally tied to the subject and [because of all that], I'm going to go to an outside resource what are the costs going to be for lease restructuring and renewal?

Greg Apter: Typically, what we try to do is make it a success-based formula so that everybody's interests are aligned. There are certain caveats but as a general matter what we try to do is make it a contingency-based scenario so that the dollars that it costs a tenant or a client are directly attributable to how much savings or value we can get for them.

That could be as a percentage of the savings achieved. It could be flat fees relative to non-economic changes to leases. But, at the end, we try to align our interests with the client. And we typically allow the client to say yes or no to any deals submitted.

They're not compelled to say yes just because we've submitted a deal to them. What we do is briefly go back and [present an] overview; we meet management from the beginning. We look at the portfolio. We explain where we think the opportunities are and aren't.

We then try to understand what management's goals and objectives are. If we think that management has a sound goal, a sound objective and there's reason for us to work together, then we want to secure that opportunity and [let the client] know that we're going to be working in the same direction to try to get results.

Mary Jo Larson: That brings us to the end of our discussion as far as my questions are concerned today. Neil and Greg are you ready to take some caller questions?

Greg Apter: Sure.

Neil Aaronson: Happy to.

Mary Jo Larson: David may we have the first caller and question please?

Operator: Thank you. The question and answer session will be conducted electronically.

And we have no one in queue at this time ma'am.

Mary Jo Larson: OK. Neil or Greg, you can answer this question for me. What is the one thing that operators should be keeping their eye on in 2010? If you had to choose or isolate something, what is the one thing that you see as the biggest opportunity or maybe the biggest pitfall that's going to be happening this year?

Neil Aaronson: I think in terms of opportunity, Mary Jo. it will be issues [that involve both the] balance sheet and the availability of capital. But for those restaurant chains that really have goals of long-term growth, I'm not saying that now is the only time [they will have] the ability to take advantage of low market rents. [The rents won't] evaporate over the next six months or 12 months.

I don't think that would happen. But I certainly think there's a great window of opportunity right now to expand and take advantage of very low lease rates, lots of great space that's available and lots of great real estate that's available.

So, again, the number one thing that we're talking about to healthy operators is get your ducks in a row, be strategic, be very forward looking and be thoughtful as to what your expansion plans are and contact us because we can really help you.

We know where all of the availability is and we can help you assess which availability is right and wrong for you. And we can help you strategically plan how to grow and how to achieve your long-term objectives while taking less risk because of the opportunities in the real estate market.

Greg Apter: A slightly different twist. There is opportunity available for everybody, not just on growth but on controlling costs. And what shouldn't be overlooked is [the chance to save] every dollar, be it through a renewal or through a renegotiation of an existing lease or a termination of an existing lease.

Therefore, an elimination of costs going forward [means] every dollar goes to the bottom line. And that increased EBITDA will then be reflected in the types of credit that is available to you and what [are] the types of opportunities that you can get with landlords.

The stronger you are in terms of credit, obviously, the better facility you get with your lender. The stronger you are as a credit, the better deals you're going to get from a landlord because they're going to be more interested in having not only you but your customers.

And then is it a center? Is it a free standard? You've got to think about boosting the bottom line. It won't be just the top line [that will] positively affect you going forward and there will be opportunities for strategic expansion for several years.

There's going to be nothing that materially improves in the commercial real estate market over the next couple of years. As Neil said before, the best sites will always be in some level of demand. It was a rare occurrence for those six or nine months where there was absolutely no expansion at all.

Even [for] the best sites, those days are over. But they're still going to be careful strategic expansion. There will be sites available. Stay disciplined and don't take unnecessary chances. Grow but grow with discipline.

Neil Aaronson: Mary Jo, the one thing I would answer on the pitfall side is a somewhat self serving answer and I don't mean it to be. But it's the truth. There are a lot of companies that sort of lightly take a stab at lease restructuring on their own.

They don't really know exactly what the right techniques are or where the right leverage points are. But their board of directors has come to them and said hey I heard XYZ other company restructured their leases and saved money on their leases. Why aren't you guys doing it?

Or they've read in a paper that somebody else is doing it and they think they should take a shot themselves. And if they don't have the right plan in place and if they don't have the right understanding of the leverage in place, it really will backfire.

And once you've taken that first shot and if you haven't laid the groundwork properly, it will be hard to backtrack and actually lay the groundwork later and do it properly. So a major pitfall to avoid is taking a stab at this stuff on your own.

There are folks who are qualified to do [this work] and have experience doing it on their own. And they'll think through what the right strategy is and think through the right leverage points. But we have encountered—I wouldn't even throw out a number—numerous clients last year coming to us and saying, "We took a stab at this and we failed. We realize we need the pros. Can you come in and help us?" And they've made mistakes that are so dramatic that maybe we can help them but we can't help them as much as we could have helped them if they hadn't [tried to do it on their own].

And in certain cases it's gotten to the point where there's really nothing we can do because the damage has been done and the opportunity to restructure the lease has gone away. So the major pitfall is if you are really thinking of doing this [on your own] then think through the strategy.

Figure out if you need an outside firm to represent you. I would again being self serving, But don't go at it, if you'll excuse the language, half-assed. You've got to really know what you're doing and you've got to really lay the groundwork properly.

Mary Jo Larson: So no false starts. False starts aren't allowed.

Greg Apter: First, communication with the landlord is absolutely critical because you're either going to put yourself down the right path or you're going to cause irreparable harm; it's really as simple as that. And there could be millions of dollars left on the table.

And we can pretty much assure you that it's rare that anybody in-house at a retailer or at a restaurant chain can pull in the savings and the value that we can pull in.

Mary Jo Larson: David, are there any callers ready to ask a question.

Operator: Yes, we'll go first to Matthew Lew with Deloitte. Your line is open.

Matthew Lew: This is for Hilco. In what states are you seeing the most activity with lease restructuring?
We work a lot in Arizona. Is that a hot spot right now?

Greg Apter: Arizona's a hot spot. Also California and Florida but really there's no narrowing of [the map]..
I would say that the distress is a little bit more dramatic in the states that I've just referenced.
Opportunity is based on supply and demand and the leverage you use.

That being said, the economic condition is such where replacement tenants are not available.
Rents are going down farther and faster in those few states. Lease-up time is worse.

Conversion costs are greater and deeper for a restaurant chain that doesn't know if it's going to lose a current tenant if they don't cooperate. Therefore, the results are typically on the high side in those states.

Matthew Lew: What part of California? Is it all over or are there specific areas?

Greg Apter: It's pretty much all over although I'd venture to say it might be a little bit more advantageous in the nonurban areas, not in highly populated Los Angeles or highly populated San Francisco. Pretty much all other parts of the state are free game.

It's not quite as dramatic as in Arizona, the Las Vegas area or in Florida. A couple of areas like that; but it also expands to all the places Neil referenced. [In] all the secondary, tertiary markets and even the best markets with anything from C [class] real estate or worse, results are extremely productive right now for tenants.

Matthew Lew: Thank you.

Operator: We'll go next to Jerry Vlamincck with Hospitality Services Corporation.

Jerry Vlamincck: Neil and Greg, Your fee-based compensation, is that coming from the client being the restaurant and franchise or and/or the landlord? Or is it typically a combination?

Greg Apter: The fee is typically between us and our client, which is the tenant.

Jerry Vlamincck: OK. Got it. So they're paying you depending on the percent of savings that you bring to the table for them and you're not actually going back to landlords on a restructuring and getting a fee from the landlord?

Greg Apter: That is right. This is another point. Part of the conversations, often with landlords, is by doing [a renegotiation] with us now you're not going to have to worry about losing us as a tenant therefore not having to worry about re-tenanting, your down time, your tenant improvement allowance, paying another broker, etc.

We take that [point] into consideration in most of our conversations and we pull additional value out of them. So it's really six of one, half-dozen of the other in most respects.

Jerry Vlaminck: Sure, because if the tangle's weighted, they have to pay somebody to bring somebody else in so you can figure that [becomes] the savings they're going to have going forward.

Greg Apter: Precisely.

Neil Aaronson: Exactly.

Jerry Vlaminck: Got it. Appreciate it.

Operator: We'll go next to Todd Lukasik with Morningstar.

Todd Lukasik: I had a question regarding client inquiries that you all are getting. If you could characterize the situation today versus what you saw 6, 12, 18 months ago, both in terms of the pace of the inquiries and the split between clients looking to restructure versus those who want to grow opportunistically.

Greg Apter: The majority of what we're getting these days is contraction as opposed to growth. I'd say a significant majority, probably 80-plus percent as Neil just whispered to me. The division between retail and restaurant is actually a bit curious to us.

And it goes back to a point that Neil made earlier. Retail took a tremendous hit and the massive restructurings have largely played out, although there continues to be some trickles and necessary restructuring. Now even though most in the restaurant industry thought that more restructurings would occur a year-plus ago, not that much has really taken hold and we're seeing a lot of it beginning to start now. As Neil said before, I think we talked to five or six different companies in the last few weeks alone and we're starting projects for at least three or four of them in the next two to three weeks.

I think we see a lot more of this [activity] playing out. Some of this is lender based because the cash-flow issue is interesting. When you have restaurant chains that are struggling lenders and also have different decisions to make, what are they supposed to do about it?

How do they get their loan repaid? It's a cash flow loan essentially, so should they force it into bankruptcy? Should they work an out-of-court restructuring where there's some sort of a debt to equity swap? If they're going to do that, be it in bankruptcy or out, when's the right time to restructure?

We're getting a lot of those questions because there's just much too much debt on the balance sheets of a lot of these companies. This is true whether it's privately held through private equities firms or whether it is just mom and pop owned or if it is a public company. All these are questions are coming to us right now.

Todd Lukasik: In terms of the pace of inquiries today versus 12 or 18 months ago, would you say its relatively stable and has just the mix changed toward restaurants? Or is it higher or lower?

Greg Apter: Generally speaking, the velocity is a little bit lower. It's still pretty significant. I would also say that you're not getting those "monsters" quote/unquote these days. We were representing Ritz Camera and Valley Total Fitness and Mervyn's and (Bozcop) and all these other big ones.

You're getting a lot of what we would deem, no disrespect intended, the smaller to mid-tier size, the 50 to 200 size. There aren't a lot of the 1,000s, 2,000s out there. A lot of them played out in retail and those where we're getting most of our calls in the past few weeks.

Todd Lukasik: Thanks for taking my questions.

Neil Aaronson: Our pleasure.

Operator: We'll go next to Douglas Heinrich with Long John Silver's.

Douglas Heinrich: What is the minimum amount of leases you'd be willing to renegotiate for a client?

Neil Aaronson: We get that question a lot and the reality is there really is no minimum. We have taken on, at times, several clients with less than 10 leases. I'd say on average we're taking on assignments with leases in the 10s or often times in the 100s and in some cases even in the 1,000s.

But, really, the answer is do we think that we have the opportunity to work with that client and create meaningful value. [That is, if the circumstances are right and if the lease is a big enough store and if the story is right and the leverage is right.

We will absolutely take on a client with just one lease. And, as I said before, it boils down to circumstances, leverage and the ability from our perspective to create meaningful value for that client.

We would encourage anybody who's really considering going down the path of lease restructuring not to ever think, "Well I'm probably too small."

[You] won't be taken seriously nor be given the proper consideration. We're always happy to see opportunity. And [if] we think we can create meaningful value, we can assure you we're going to give 100 percent effort to assist you in getting the job done.

Douglas Heinrich: One follow-up question, if I could. How successful are you in renegotiating leases without extending lease term?

Greg Apter: That's really dependent upon the facts that we can communicate to the landlord. It depends on are you healthy? Are you stressed? Are you distressed? In bankruptcy? Out? All those are really background questions that would need to be understood to give you that answer.

I can be 100 percent straightforward with you, though. If, for example, you work for a company like Wal-Mart, which is an extraordinary company. And you've got 10 years to go on a lease and you want us to renegotiate it without extending term. It's not worth your time.

I don't want to play games and communicate a mixed message. If the facts exist, if the story exists, if we can deliver the message and the materials to the landlord that show a compelling reason why they should cooperate, you're going to get a meaningful percentage of deals done.

I won't give the name but we have one client that has 20,000-square foot locations. They're a very important anchor in a lot of secondary and tertiary markets. We are negotiating quite a bit of that portfolio not the entire portfolio.

The quote/unquote "threat to close" would be devastating to a landlord. So it isn't just about extending term. It's about maybe agreeing to some level of a continuous operation in exchange for reducing those rents.

And we've had some very good success getting that done. So you've got to apply the facts and the circumstances and then figure out where everybody's comfortable delivering the message to give yourself a range of success.

Mary Jo Larson: David, I think we have time for one more question.

Operator: We'll go next to Richard Ludwig with Ludwig & Seeley.

Richard Ludwig: My question is I think partially answered. What are the tradeoffs that you could offer and what are the other non-financial [elements] that you're looking for in a renegotiation?

Greg Apter: It's really up to the client. Typically it's fairly narrow and it can be additional options. It could be a tweak to the use clause or the assignment clause. It's very client specific and it depends on the core of what they're trying to accomplish.

I can tell you that it's fairly atypical. And I only referenced it briefly before. If we're in the middle of a restructuring and it's outside of a bankruptcy, it's fairly atypical to start renegotiating eight or 10 or 12 different provisions of leases.

Usually you focus on savings, lease term and one or two other core pieces that the company believes are critical for improvements of the go-forward location.

Mary Jo Larson: I think that brings us to the end of our teleconference today. As mentioned at the outset the entire discussion was taped. It will be transcribed, edited and soon appear as a feature article on Franchise Times and Restaurant Finance Monitor.

Also under discussion is a possible break-out session at the Restaurant Finance and Development Conference in November. On behalf of Neil, Greg, Franchise Times and Hilco Real Estate, thank you for being on the call today. Thank you for joining us.

END