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MORGANS FOODS INC  
Form 10-Q  
December 19, 2001

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 period ended November 4, 2001  
Commission file number 0-3833

Morgan's Foods, Inc.

(Exact name of registrant as specified in its charter)

Ohio 34-0562210  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

24200 Chagrin Boulevard, Suite 126, Beachwood, Ohio 44122  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (216) 360-7500

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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   
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As of December 19, 2001, the issuer had 2,745,341 shares of common stock outstanding.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Morgan's Foods, Inc.

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## CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	QUARTER ENDED	
	NOVEMBER 4, 2001	NOVEMBER 5, 2000
Revenues .....	\$ 20,418,000	\$ 18,719,000
Cost of sales:		
Food, paper and beverage .....	6,134,000	6,109,000
Labor and benefits .....	5,107,000	5,001,000
Restaurant operating expenses .....	5,284,000	4,753,000
Depreciation and amortization .....	893,000	903,000
General and administrative expenses .....	1,210,000	1,277,000
Loss on restaurant assets (Note 4) .....	81,000	205,000
	-----	-----
Operating income .....	1,709,000	471,000
Interest expense:		
Bank debt and notes payable .....	(1,157,000)	(1,176,000)
Capital leases .....	(16,000)	(19,000)
Other income and expense, net .....	25,000	52,000
	-----	-----
Income (loss) from continuing operations before income taxes .....	561,000	(672,000)
Provision for income taxes .....	9,000	3,000
	-----	-----
Income (loss) from continuing operations ...	552,000	(675,000)
Gain from discontinued operations (Note 2) .	--	137,000
	-----	-----
Net income (loss) .....	\$ 552,000	\$ (538,000)
	=====	=====
Basic income (loss) per Common share (Note 3):		
Income (loss) from continuing operations	\$ .20	\$ (.23)
Income from discontinued operations ....	--	.05
	-----	-----
Net income (loss) per share .....	\$ .20	\$ (.18)
	=====	=====
Diluted income (loss) per common share (Note 3):		
Income (loss) from continuing operations	\$ .20	\$ (.23)
Income from discontinued operations ....	--	.05
	-----	-----
Net income (loss) per share .....	\$ .20	\$ (.18)
	=====	=====
Basic weighted average number of shares outstanding .....	2,795,524	2,937,572
Diluted weighted average number of shares outstanding .....	2,797,635	2,937,572

See notes to consolidated financial statements.

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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements.

Morgan's Foods, Inc.

#### CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	THIRTY-SIX WEEKS ENDED	
	NOVEMBER 4, 2001	NOVEMBER 5, 2000
Revenues .....	\$ 58,964,000	\$ 55,567,000
Cost of sales:		
food, paper and beverage .....	17,982,000	17,706,000
Labor and benefits .....	15,162,000	14,835,000
Restaurant operating expenses .....	15,122,000	13,705,000
Depreciation and amortization .....	2,667,000	2,624,000
General and administrative expenses .....	3,517,000	3,851,000
Loss on restaurant assets (Note 4) .....	112,000	421,000
	-----	-----
Operating income .....	4,402,000	2,425,000
Interest expense:		
Bank debt and notes payable .....	(3,526,000)	(3,488,000)
Capital leases .....	(49,000)	(57,000)
Other income and expense, net .....	105,000	118,000
	-----	-----
Income (loss) from continuing operations		
before income taxes .....	932,000	(1,002,000)
Provision for income taxes .....	10,000	10,000
	-----	-----
Income (loss) from continuing operations .	922,000	(1,012,000)
Gain from discontinued operations (Note 2)	--	137,000
	-----	-----
Net income (loss) .....	\$ 922,000	\$ (875,000)
	=====	=====
Basic income (loss) per		
common share (Note 3):		
Income (loss) from continuing operations	\$ .32	\$ (.35)
Income from discontinued operations ....	--	.05
	-----	-----
Net income (loss) per share .....	\$ .32	\$ (.30)
	=====	=====
Diluted income (loss) per		
common share (Note 3):		
Income (loss) from continuing operations	\$ .32	\$ (.35)
Income from discontinued operations ....	--	.05
	-----	-----
Net income (loss) per share .....	\$ .32	\$ (.30)
	=====	=====
Basic weighted average number of		

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shares outstanding .....	2,882,442	2,928,441
Diluted weighted average number of		
shares outstanding .....	2,883,776	2,928,441

See notes to consolidated financial statements.

3

### MORGAN'S FOODS, INC.

#### CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	NOVEMBER 4, 2001	FEBRUARY 25, 2001
	-----	-----
<b>Assets</b>		
Current assets:		
Cash and equivalents .....	\$ 6,898,000	\$ 5,840,000
Receivables .....	49,000	78,000
Inventories .....	521,000	488,000
Prepaid expenses .....	346,000	222,000
	-----	-----
	7,814,000	6,628,000
Property and equipment:		
Land .....	10,801,000	10,802,000
Buildings and improvements .....	17,913,000	17,701,000
Property under capital leases .....	1,006,000	1,006,000
Leasehold improvements .....	7,439,000	7,294,000
Equipment, furniture and fixtures .....	17,962,000	17,771,000
Construction in progress .....	75,000	110,000
	-----	-----
	55,196,000	54,684,000
Less accumulated depreciation and amortization ...	16,319,000	14,130,000
	-----	-----
	38,877,000	40,554,000
Other assets .....	1,537,000	1,621,000
Franchise agreements .....	2,160,000	2,241,000
Deferred taxes .....	600,000	600,000
Acquired franchise rights .....	9,537,000	9,910,000
	-----	-----
	\$ 60,525,000	\$ 61,554,000
	=====	=====
<b>Liabilities and shareholders' equity (deficiency)</b>		
Current liabilities:		
Current maturities of long-term debt .....	\$ 2,235,000	\$ 2,076,000
Current maturities of capital lease obligations	108,000	94,000
Accounts payable .....	3,681,000	3,590,000
Accrued liabilities .....	3,122,000	3,322,000
	-----	-----
	9,146,000	9,082,000
Long-term debt .....	49,387,000	51,046,000
Long-term capital lease obligations .....	571,000	651,000
Other long-term liabilities .....	1,203,000	1,353,000

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Shareholders' equity (deficiency)		
Preferred shares, 1,000,000 shares authorized, No shares outstanding		
Common stock		
Authorized shares - 25,000,000		
issued shares - 2,969,405 .....	30,000	30,000
Treasury stock - 179,064 in 2001 and 31,833 in 2000	(171,000)	(76,000)
Capital in excess of stated value .....	28,844,000	28,875,000
Accumulated deficit .....	(28,485,000)	(29,407,000)
	-----	-----
Total shareholders' equity (deficiency) .....	218,000	(578,000)
	-----	-----
	\$ 60,525,000	\$ 61,554,000
	=====	=====

See notes to consolidated financial statements.

4

MORGAN'S FOODS, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (DEFICIENCY)

(unaudited)

	Common Shares		Treasury Shares	
	Shares	Amount	Shares	Amount
Balance, February 27, 2000 .	2,969,405	\$ 30,000	(46,678)	\$ (111,000)
Net loss .....	--	--	--	--
Issue of treasury shares for 401(k) contributions .....	--	--	14,845	35,000
Balance, February 25, 2001 .	2,969,405	30,000	(31,833)	(76,000)
Net income .....	--	--	--	--
Issue of treasury shares for 401(k) contributions .....	--	--	31,833	76,000
Purchase of common shares ..	--	--	(179,064)	(171,000)
Balance, November 4, 2001 ..	2,969,405	\$ 30,000	(179,064)	\$ (171,000)
	=====	=====	=====	=====

Total  
Shareholders'

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	Accumulated Deficit -----	Equity (Deficiency) -----
Balance, February 27, 2000 .	\$(27,864,000)	\$ 930,000
Net loss .....	(1,543,000)	(1,543,000)
Issue of treasury shares for 401(k) contributions .....	--	35,000
	-----	-----
Balance, February 25, 2001 .	(29,407,000)	(578,000)
Net income .....	922,000	922,000
Issue of treasury shares for 401(k) contributions .....	--	45,000
Purchase of common shares ..	--	(171,000)
	-----	-----
Balance, November 4, 2001 ..	\$(28,485,000) =====	\$ 218,000 =====

See notes to consolidated financial statements

5

Morgan's Foods, Inc.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

	THIRTY-SIX WEEKS ENDED	
	----- NOVEMBER 4, 2001	NOVEMBER 5, 2000 -----
Cash flows from operating activities:		
Net income (loss) .....	\$ 922,000	\$ (875,000)
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization, including deferred financing costs .....	2,765,000	2,723,000
Amortization of supply agreement advances ...	(124,000)	(69,000)
Funding from supply agreements .....	52,000	971,000
Loss on sale or disposal of restaurant assets .....	112,000	421,000
Change in assets and liabilities:		
Decrease in receivables .....	29,000	13,000
(Increase) decrease in inventories .....	(33,000)	65,000
(Increase) decrease in prepaid expenses ....	(124,000)	100,000
Increase in other assets .....	(16,000)	(11,000)
Increase (decrease) in accounts payable ....	91,000	(739,000)
Decrease in accrued liabilities .....	(286,000)	(243,000)
	-----	-----

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Net cash provided by operating activities .....	3,388,000	2,356,000
	-----	-----
Cash flows from investing activities:		
Capital expenditures .....	(583,000)	(3,112,000)
Purchase of franchise agreements and acquired franchise rights .....	(10,000)	(175,000)
Proceeds from sale of restaurant assets .....	--	2,000
	-----	-----
Net cash used in investing activities .....	(593,000)	(3,285,000)
	-----	-----
Cash flows from financing activities:		
Proceeds from issuance of long-term debt, net of financing costs .....	36,000	3,025,000
Principal payments on long-term debt .....	(1,536,000)	(1,355,000)
Principal payments on capital lease obligations .....	(66,000)	(940,000)
Purchase of treasury shares .....	(171,000)	--
	-----	-----
Net cash (used) provided by financing activities	(1,737,000)	730,000
	-----	-----
Net change in cash and equivalents .....	1,058,000	(199,000)
Cash and equivalents, beginning balance .....	5,840,000	4,612,000
	-----	-----
Cash and equivalents, ending balance .....	\$ 6,898,000	\$ 4,413,000
	=====	=====

See notes to consolidated financial statements.

6

Morgan's Foods, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 QUARTERS ENDED NOVEMBER 4, 2001 AND NOVEMBER 5, 2000  
 (unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements of Morgan's Foods, Inc. ("the Company") have been prepared without audit. In the opinion of Company Management, all adjustments have been included. Unless otherwise disclosed, all adjustments consist only of normal recurring adjustments necessary for a fair statement of results of operations for the interim periods. These unaudited financial statements have been prepared using the same accounting principles that were used in preparation of the Company's annual report on Form 10-K for the year ended February 25, 2001. Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2. DISCONTINUED OPERATIONS

The Company sold the one remaining former East Side Mario's location and the liquor license and equipment during the third quarter of fiscal 2001. The cash received as a result of these transactions was used to pay off the capital lease obligations, purchase the leased property to be sold and other expenses of the transactions. The results of operations of the discontinued

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segment are shown in the Consolidated Statements of Operations as "Gain from discontinued operations" and there is no tax effect of the gain. The Company recorded a gain on the disposal of the remaining assets. The East Side Mario's restaurants formerly operated by the Company began in March 1993 and encompassed six locations by April 1995. Comparable restaurant revenues for the East Side Mario's segment had declined since fiscal 1996 and the restaurant concept was not appropriately supported by the franchisor.

### NOTE 3. INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is based on the combined weighted average number of shares outstanding, which includes the assumed exercise, or conversion of options. In computing diluted net income (loss) per common share, the Company has utilized the treasury stock method.

### NOTE 4. IMPAIRMENT OF LONG-LIVED ASSETS

During the third quarter of fiscal 2001 the cash flow forecast for one of the Company's restaurants demonstrated continuing losses. Based upon this the Company performed an analysis comparing the net book value of this restaurants assets to the fair value of the assets. Fair value was determined by review of recent sales transactions. Based upon this analysis the Company recorded an impairment loss of \$133,000 which is included in the loss on restaurants assets.

7

### NOTE 5. NEW ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 142 addresses the accounting for goodwill and other intangible assets after an acquisition. The most significant changes made by SFAS 142 are: 1) goodwill and intangible assets with indefinite lives will no longer be amortized; 2) goodwill and intangible assets with indefinite lives must be tested for impairment at least annually; and 3) the amortization period for intangible assets with finite lives will no longer be limited to forty years. The Company plans to adopt SFAS 142 for its fiscal year beginning March 4, 2002, as required. The Company is currently evaluating the provisions of SFAS 142 and has not yet determined the effect that adoption of this standard will have on its consolidated financial position or results of operations.

In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations" which will become effective for the Company on March 2, 2003. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. The amount recorded as a liability, will be capitalized by increasing the carrying amount of the related long-lived asset. Subsequent to initial measurement, the liability is accreted to the ultimate amount anticipated to be paid and is also adjusted for revisions to the timing or amount of estimated cash flows. The capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The Company has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

In August 2001, the FASB issued SFAS 144, "Impairment or Disposal of



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Long-Lived Assets" which will become effective for the Company on March 4, 2002. This statement further refines the rules for accounting for long-lived assets and long-lived assets to be disposed of. The Company has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

8

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

DESCRIPTION OF BUSINESS. Morgan's Foods, Inc. ("the Company") operates through wholly-owned subsidiaries KFC restaurants under franchises from KFC Corporation and Taco Bell restaurants under franchises from Taco Bell Corporation. As of December 19, 2001, the Company operates 76 KFC restaurants, 7 Taco Bell restaurants, 17 KFC/Taco Bell "2n1's" under franchises from KFC Corporation and franchises or licenses from Taco Bell Corp., and 3 Taco Bell/Pizza Hut Express "2n1's" operated under franchises from Taco Bell Corporation and licenses from Pizza Hut Corporation. The Company's fiscal year is a 52 - 53 week year ending on the Sunday nearest the last day of February.

#### SUMMARY OF EXPENSES AS A PERCENTAGE OF REVENUES

	QUARTER ENDED	
	NOVEMBER 4, 2001	NOVEMBER 5, 2000
Cost of sales:		
Food, paper and beverage.....	30.0%	32.6%
Labor and benefits.....	25.0%	26.7%
Restaurant operating expenses.....	25.9%	25.4%
Depreciation and amortization.....	4.4%	4.8%
General and administrative expenses.....	5.9%	6.8%
Operating income.....	8.4%	2.5%

REVENUES. Revenues for the quarter ended November 4, 2001 were \$20,418,000 compared to \$18,719,000 for the quarter ended November 5, 2000. This increase of \$1,699,000 included an increase of 10.8% in comparable restaurant revenues which was partially offset by \$232,000 in lost sales due to restaurants being permanently or temporarily closed. The increase in comparable restaurant revenues was primarily the result of effective product promotions by the franchisors during the quarter. Revenues for the thirty-six weeks ended November 4, 2001 were \$58,964,000 compared to \$55,567,000 for the thirty-six weeks ended November 5, 2000. The increase of \$3,397,000 was attributable to \$262,000 of revenues generated by restaurants which were remodeled or to which a concept was added and a 7.8% increase in comparable restaurant revenues which was partially

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offset by \$754,000 in lost sales due to restaurants being permanently or temporarily closed.

**COSTS OF SALES - FOOD, PAPER AND BEVERAGES.** Food, paper and beverage costs for the fiscal 2002 third quarter decreased as a percentage of revenue from 32.6% in fiscal 2001 to 30.0%. This decrease was the result of several factors, including product promotions in the third quarter of fiscal 2002 having a lower food cost than those promoted during the third quarter of fiscal 2001 and by efficiencies gained due to higher average restaurant volumes. Food, paper and beverage costs were also reduced by \$259,000 received during the third quarter of fiscal 2002 as the result of a settlement negotiated by FRANMAC, the Taco Bell franchisee association, with certain system food suppliers. Food, paper and beverage costs for the thirty-six weeks ended November 4, 2001 decreased to 30.5% of revenue compared to 31.9% in the year earlier period primarily for the reasons discussed above.

**COST OF SALES - LABOR AND BENEFITS.** Labor and benefits were decreased as a percentage of revenue for the quarter ended November 4, 2001 to 25.0% compared to 26.7% for the year earlier quarter due to higher average

9

restaurant volumes, decreased benefit costs and improved operating efficiencies. Labor and benefits decreased as a percentage of revenue for the thirty-six weeks ended November 4, 2001 from 26.7% to 25.7% for the reasons discussed above.

**RESTAURANT OPERATING EXPENSES.** Restaurant operating expenses increased as a percentage of revenue to 25.9% in the third quarter of fiscal 2002 compared to 25.4% in the third quarter of fiscal 2001 due mainly to higher repairs and maintenance costs and an increase in KFC national advertising expenses from 2.0% of KFC revenues to 2.5% of KFC revenue. The increased advertising was approved by the national advertising co-op and will remain in effect for the foreseeable future. Restaurant operating expenses for the thirty-six weeks ended November 4, 2001 increased to 25.7% of revenue compared 24.7% of revenue in the comparable prior year period for the reasons discussed above.

**DEPRECIATION AND AMORTIZATION.** Depreciation and amortization for the fiscal 2002 third quarter was substantially unchanged at \$893,000 compared to \$903,000 in the prior year third quarter. Depreciation and amortization for the thirty-six weeks ended November 4, 2001 increased to \$2,667,000 from \$2,624,000 for the year earlier period primarily due to the addition of concepts to 3 restaurants.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses decreased to \$1,210,000 in the third quarter of fiscal 2002 from \$1,277,000 in the third quarter of fiscal 2001. This decrease of \$67,000 was mainly the result of improved cost control at both the Corporate and field operations levels as well as \$90,000 in fees accrued to pay an advisor to solicit indications of interest for the Company in the prior year quarter and partially offset by increased accruals for bonuses due to the improved operating results in the current year quarter. General and administrative expenses for the thirty-six weeks ended November 4, 2001 decreased to \$3,517,000 compared to \$3,851,000 for the year earlier period primarily for the reasons discussed above.

**LOSS ON RESTAURANT ASSETS.** The loss on restaurant assets decreased to \$81,000 in the third quarter of fiscal 2002 from \$205,000 in fiscal 2001. The loss on restaurant assets in the third quarter of fiscal 2002 was the result of an increase in the reserve for the costs necessary to dispose of previously closed restaurants and the write off of previously capitalized pre-construction

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costs related to projects which management has determined will not be undertaken. The loss on restaurant assets in the third quarter of fiscal 2001 was the result of an impairment loss of \$133,000 for the excess of net book value over fair value of a restaurant (see Note 4 for further details) and an increase in the reserve for the costs necessary to dispose of previously closed restaurants.

**OPERATING INCOME.** Operating income in the third quarter of fiscal 2002 increased to \$1,709,000 or 8.4% of revenue compared to \$471,000 or 2.5% of revenue for the third quarter of fiscal 2001. This increase was primarily the result of higher average restaurant volumes, improved operating efficiencies and the receipt of the settlement with certain Taco Bell system food suppliers mentioned earlier. Operating income for the thirty-six weeks ended November 4, 2001 increased to \$4,402,000 or 7.5% of revenue from \$2,425,000 or 4.4% of revenue for the reasons discussed above.

**INTEREST EXPENSE.** Interest expense on bank debt decreased to \$1,157,000 in the third quarter of fiscal 2002 from \$1,176,000 in fiscal 2001 due to lower debt balances which has occurred as a result of the Company continuing to pay down its debt and not incurring any significant new debt during the current year periods. Interest expense on bank debt for the thirty-six weeks ended November 4, 2001 increased to \$3,526,000 from \$3,488,000 due to the addition of debt for the construction of restaurants in previous quarters. Interest expense on capitalized leases was substantially unchanged from the prior year third quarter and for the thirty-six weeks.

10

**OTHER INCOME.** Other income for the quarter ended November 4, 2001 decreased to \$25,000 from \$52,000 in the prior year third quarter. The decrease is due mainly to decreased interest income earned on cash balances as a result of lower rates of return. Other income for the thirty-six weeks ended November 4, 2001 decreased to \$105,000 from \$118,000 due to the reasons discussed above.

**PROVISION FOR INCOME TAXES.** The provision for income taxes for the third quarter ended November 4, 2001 increased to \$9,000 as compared to \$3,000 for the year earlier period due to the improved operating results discussed above. The provision for income taxes for the thirty-six weeks ended November 4, 2001 is substantially unchanged from the prior year.

**DISCONTINUED OPERATIONS.** On September 3, 1999, Management made the decision to discontinue the operation of its East Side Mario's restaurant segment. The Company sold the one remaining former East Side Mario's location and the liquor license and equipment during the third quarter of fiscal 2001. The cash received as a result of these transactions was used to pay off the capital lease obligations, purchase the leased property to be sold and other expenses of the transactions. The results of operations of the discontinued segment are shown in the Consolidated Statements of Operations as "Gain from discontinued operations" and there is no tax effect of the gain. The Company recorded a gain on the disposal of the remaining assets.

**LIQUIDITY AND CAPITAL RESOURCES.** Cash flow activity for the thirty-six weeks of fiscal 2002 and fiscal 2001 is presented in the Consolidated Statements of Cash Flows. Cash provided by operating activities was \$3,388,000 for the thirty-six weeks ended November 4, 2001. The Company paid scheduled long-term bank and capitalized lease debt of \$1,602,000 in the first thirty-six weeks of fiscal 2002.

The quick service restaurant operations of the Company have historically provided sufficient cash flow to service the Company's debt,

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refurbish and upgrade the Company's restaurant properties and cover administrative overhead. Management believes that operating cash flow will provide sufficient capital to continue to operate and maintain its restaurants, service the Company's debt and support required corporate expenses.

Certain of the Company's debt arrangements require the maintenance of a consolidated fixed charge coverage ratio of 1.2 to 1.0 regarding all of its mortgage loans and individual restaurant coverage ratios of 1.4 to 1.0 on certain of its loans as measured at each of the Company's fiscal year ends. At February 25, 2001, the Company was in compliance with the consolidated ratio of 1.2 applicable to \$43,621,000 of its loans and fell short of compliance on the consolidated ratio regarding \$6,501,000 of its loans with another lender. Additionally, the Company was not in compliance with the 1.4 unit level ratio on certain of its restaurants. The Company obtained waivers of these violations from the applicable lenders and expects to be in compliance with the minimum coverage ratios and other terms and conditions of the agreements by the end of fiscal 2002.

The Company is currently not in full compliance with the American Stock Exchange financial condition guidelines for continued listing. Specifically, the guidelines indicate that any company with shareholders' equity less than \$4,000,000 and losses in 3 of its last 4 fiscal years may be considered for delisting. This condition has been reviewed with representatives of the American Stock Exchange who indicated that the Company's performance will continue to be monitored by the Exchange.

The Board of Directors of the Company at its meeting on June 22, 2001 authorized the purchase of up to 250,000 shares of the Company's common stock in the open market from time to time over the next twelve months. On July 11, 2001 the Company purchased 73,730 shares which constitutes all of the stock formerly held

11

by the Morgan's Foods, Inc. 401(k) Profit Sharing Plan under authority granted by the Board of Directors specifically for that purpose. On August 13, 2001 and October 18, 2001 the Company purchased 100,334 and 5,000 shares respectively under its previously disclosed authorization to purchase 250,000 shares during the twelve months ending June 21, 2002. Also, subsequent to the end of the fiscal third quarter, the Company purchased 45,000 additional shares in the open market under the same 250,000 share authorization.

SEASONALITY. The operations of the Company are affected by seasonal fluctuations. Historically, the Company's revenues and income have been highest during the summer months with the fourth fiscal quarter representing the slowest period. This seasonality is primarily attributable to weather conditions in the Company's marketplace, which consists of portions of Ohio, Pennsylvania, Missouri, Illinois, West Virginia and New York.

12

### 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.

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Morgan's Foods, Inc.

-----  
(Registrant)

By: /s/ Kenneth L. Hignett

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Kenneth L. Hignett  
Senior Vice President,  
Chief Financial Officer & Secretary

Dated: December 19, 2001