MORTONS RESTAURANT GROUP INC
Form 10-Q
August 17, 2004

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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

For the quarterly period ended July 4, 2004

OR

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

For the transition period from to

Commission file number 1-12692

MORTON S RESTAURANT GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-3490149**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
3333 New Hyde Park Road, Suite 210, New Hyde Park, New York	**11042**
(Address of principal executive offices)	(Zip code)

516-627-1515
(Registrant s telephone number, including area code)

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 ý or No o.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o or No ý.

As of August 17, 2004, the registrant had 1,000 shares of its Common Stock, $0.01 par value, outstanding.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

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Part I - Financial Information

Item 1. Financial Statements

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(amounts in thousands)

	July 4, 2004 (unaudited)	January 4, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 2,278	$ 17,997
Restricted cash	1,021	1,100
Marketable securities	1,741	
Accounts receivable	3,042	3,829
Inventories	9,483	9,094
Prepaid expenses and other current assets	5,887	5,069
Deferred income taxes	6,523	7,076
Total current assets	29,975	44,165
Property and equipment, at cost:		
Furniture, fixtures and equipment	15,133	14,131
Buildings and leasehold improvements	39,088	38,667
Land	8,474	8,474
Construction in progress	2,294	338
	64,989	61,610
Less accumulated depreciation and amortization	10,352	7,500
Net property and equipment	54,637	54,110
Intangible asset	92,000	92,000
Goodwill	61,552	61,552
Other assets and deferred expenses, net	9,791	10,360
	$ 247,955	$ 262,187

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets, Continued

(amounts in thousands, except share and per share amounts)

		July 4, 2004 (unaudited)		January 4, 2004
Liabilities and Stockholder s Equity				
Current liabilities:				
Accounts payable	$	5,980	$	6,111
Accrued expenses		23,393		27,955
Current portion of obligations to financial institutions		497		658
Accrued income taxes		47		296
Total current liabilities		29,917		35,020
7.5% senior secured notes, net of unamortized discount of $14,157 and $14,987 at July 4, 2004 and January 4, 2004		90,843		90,013
Obligations to financial institutions, less current maturities		6,903		12,274
Deferred income taxes		20,471		20,471
Other liabilities		2,957		2,087
Total liabilities		151,091		159,865
Commitments and contingencies				
Stockholder s equity:				
Common stock, $0.01 par value per share. Authorized, issued and outstanding 1,000 shares at July 4, 2004 and January 4, 2004				
Additional paid-in capital		97,076		97,075
Accumulated other comprehensive income		70		128
(Accumulated deficit) retained earnings		(282)		5,119
Total stockholder s equity		96,864		102,322
	$	247,955	$	262,187

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(amounts in thousands)

	Three month periods ended		Six month periods ended	
	July 4, 2004	**June 29, 2003**	**July 4, 2004**	**June 29, 2003 Restated (see Note 2)**
		(unaudited)		
Revenues	$ 64,911	$ 59,746	$ 137,892	$ 124,862
Food and beverage costs	21,988	19,865	46,462	41,860
Restaurant operating expenses	31,042	29,226	63,242	59,351
Pre-opening costs, depreciation, amortization and non-cash charges	2,157	1,858	4,187	4,296
General and administrative expenses	4,662	3,781	9,548	7,817
Marketing and promotional expenses	2,240	1,108	4,869	2,575
Costs associated with the repayment of certain debt			264	
Interest expense, net	2,866	1,435	5,937	3,076
Management fee paid to related party	700	700	1,400	1,400
(Loss) income before income taxes	(744)	1,773	1,983	4,487
Income tax (benefit) expense	(223)	532	595	1,334
Net (loss) income	$ (521)	$ 1,241	$ 1,388	$ 3,153

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(amounts in thousands)

	Six month periods ended July 4, 2004	Six month periods ended June 29, 2003 Restated (see Note 2)
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 1,388	$ 3,153
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash charges	5,338	3,426
Deferred income taxes	553	1,108
Change in assets and liabilities:		
Accounts receivable	784	2,679
Income taxes receivable		251
Inventories	(399)	216
Prepaid expenses and other assets	(792)	1,548
Accounts payable, accrued expenses and other liabilities	(4,158)	(7,718)
Accrued income taxes	(254)	(103)
Net cash provided by operating activities	2,460	4,560
Cash flows from investing activities:		
Purchases of property and equipment	(3,638)	(2,360)
Increase in marketable securities	(1,741)	
Net cash used in investing activities	(5,379)	(2,360)
Cash flows from financing activities:		
Principal reduction on obligations to financial institutions and capital leases	(5,532)	(7,853)
Proceeds from obligations to financial institutions		5,900
Payment of deferred financing costs	(550)	
Dividends paid	(6,789)	
Decrease in restricted cash	79	
Net cash used in financing activities	(12,792)	(1,953)
Effect of exchange rate changes on cash	(8)	42
Net (decrease) increase in cash and cash equivalents	(15,719)	289
Cash and cash equivalents at beginning of period	17,997	1,703
Cash and cash equivalents at end of period	$ 2,278	$ 1,992

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

July 4, 2004 and June 29, 2003

1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Morton s Restaurant Group, Inc. and its subsidiaries (the Company, we, us and our) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the Annual Report on Form 10-K for the fiscal year ended January 4, 2004.

The accompanying consolidated financial statements are unaudited and include all adjustments (consisting of normal recurring adjustments and accruals) that management considers necessary for a fair presentation of its financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates and assumptions relating to the reported amount of assets, liabilities, revenues and expenses reported during the period. Actual results could differ from those estimates.

The Company uses a 52/53 week fiscal year which ends on the Sunday closest to January 1. Approximately every six or seven years, a 53rd week will be added. Fiscal 2003 was a 53 week year.

2) Restatement of Consolidated Financial Statements

The effect of the restatement discussed herein on the Company s results as of and for the fiscal year ended January 4, 2004 was reflected in the Company s Annual Report on Form 10-K. The Company has restated its consolidated financial statements for the three month period ended March 30, 2003 and six month period ended June 29, 2003 as a result of having incorrectly provided estimates for expirations and non-redemption of gift certificates that it had sold. The effect of the restatement was to reduce revenues for the three month period ended March 30, 2003 in the amount of $137,000 and accordingly reduce revenues for the six month period ended June 29, 2003 in the amount of $137,000. The restatement had no effect on the Company s net operating cash position. The impact of the above-mentioned restatement on the consolidated statement of operations for the six month period ended June 29, 2003 is as follows (amounts in thousands):

	Six month period ended June 29, 2003

	Reported	Restated
Revenues	$ 124,999	$ 124,862
Income before income taxes	4,624	4,487
Income tax expense	1,387	1,334
Net income	3,237	3,153

3) Recent Events

On June 3, 2004, the Company paid a dividend of $6,789,000 to its parent, Morton s Holdings, LLC (MHLLC).

On June 4, 2004, Morton s Holding Company, Inc. (MHCI), a newly formed wholly-owned subsidiary of MHLLC, became an intermediate holding company and the direct parent of the Company. Subsequently, MHCI completed a $40,000,000 14% senior secured notes offering. The notes are secured by the assets of MHCI, which include the stock of the Company. The notes are not secured by the assets of, nor are they guaranteed by, the Company or any of its subsidiaries. MHCI used the proceeds of the offering to make a distribution to MHLLC s equity holders and to pay fees and expenses related to the issuance.

4) Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, the Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. The Company paid cash interest, net of amounts capitalized, of approximately $4,811,000 and $3,455,000, and income taxes of approximately $318,000 and $202,000, for the six month periods ended July 4, 2004 and June 29, 2003, respectively.

5) Restricted Cash

Restricted cash of $1,021,000 and $1,100,000 as of July 4, 2004 and January 4, 2004, respectively, represents cash collateral relating to two interest rate swap agreements with Bank of America, formerly Fleet National Bank (B of A). See Note 8.

6) Marketable Securities

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standard (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. In accordance with SFAS No. 115, marketable securities of approximately $1,741,000 as of July 4, 2004 are accounted for as trading securities. Securities held by the Company are bought and held principally for the purpose of selling them in the near term and are recorded at fair value. Unrealized gains and losses on such securities have been recognized in interest expense, net in the consolidated statements of operations.

7) Intangible Asset and Goodwill

The identifiable intangible asset acquired represents the Company s trade name Morton s, which has an indefinite life and accordingly is not subject to amortization, but is subject to impairment testing. The trade name is used in the advertising and marketing of the restaurants and is widely recognized and accepted by consumers in its respective market as an indication of and recognition of service, value and quality. Goodwill represents the excess of costs over fair value of assets of the business acquired.

8) Derivative Financial Instruments

The Company accounts for its derivative financial instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. As of July 4, 2004, the Company s derivative financial instruments consist of two interest rate swap agreements with notional amounts of $20,000,000 each. Prior to the July 7, 2003 repayment of our prior credit facility with a portion of the proceeds from our 7.5% senior secured notes offering, the interest rate swap agreements were originally designated as cash flow hedges for purposes of SFAS No. 133. As a result of such repayment, these two interest rate swap agreements, which are due to expire on October 24, 2004 and October 24, 2005, are accounted for as speculative instruments and resulting changes in their fair market value have been charged or credited to the consolidated statement of operations. As of July 4, 2004 and January 4, 2004, in accordance with SFAS No. 133, liabilities were approximately $385,000 and $723,000, respectively. The change in the fair market value has been recognized in interest expense, net in the consolidated statement of operations for the three and six month periods ended July 4, 2004.

9) Comprehensive Income

The components of comprehensive income for the six month periods ended July 4, 2004 and June 29, 2003 are as follows (amounts in thousands):

	Six month periods ended July 4, 2004	June 29, 2003 Restated
Net income	$ 1,388	$ 3,153
Other comprehensive income (loss):		
Foreign currency translation	(58)	(1)
Change in fair value of interest rate swap agreements		(200)
Total comprehensive income	$ 1,330	$ 2,952

10) Morton s 90 West Street, NY

As a result of the impact of the World Trade Center terrorist attacks on September 11, 2001, the Morton s steakhouse restaurant located at 90 West Street, New York, New York, two blocks from the World Trade Center was closed permanently due to structural damage. During the six month period ended June 29, 2003, the Company recorded a benefit in Restaurant operating expenses in the accompanying consolidated statement of operations of approximately $862,000 representing business interruption insurance recovery related to costs incurred from the closing of that restaurant. There were no comparable benefits recorded during the six month period ended July 4, 2004. During March 2004, the Company received approximately $1,007,000 for such insurance. As of July 4, 2004, cumulative benefits recorded were approximately $3,619,000 and cumulative amounts received were approximately $3,619,000 for this insurance. Based on the insurance policy coverage, the Company believes that additional benefits will be recorded in fiscal 2004 and possibly in future periods relating to future insurance recoveries, although there is no assurance that any future recoveries will be received.

11) Employee Subscription Agreements

Certain of our executives and other employees have been granted common units of MHLLC, which represent an ownership interest in MHLLC, pursuant to employee subscription agreements. MHLLC s Board approved 1,711,344 units available for grant of which 1,497,585 and 26,200 were granted on August 26, 2003 and June 21, 2004, respectively. On August 26, 2003 and June 21, 2004, the fair value of each common unit granted was $0.01. Common units granted to an employee pursuant to employee subscription agreements are granted at no cost to the employee. These common units are subject to vesting. Fifty percent of the granted common units vest upon certain dates if the employee is employed as of such date. In addition, fifty percent of the common units will vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30% and the employee is employed as of such date. Upon termination of employment, unvested common units will be forfeited and vested common units will be subject to repurchase pursuant to the terms of MHLLC s operating agreement. Stock-based employee compensation expense related to this plan will be charged to the Company based on the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, the Company recognized compensation expense relating to the vesting of common units granted in our consolidated statement of operations for the three and six month periods ended July 4, 2004. The compensation expense recorded during the three and six month periods ended July 4, 2004, represents the straight-line amortization of the difference between the fair value at the date of grant of $0.01 per common unit and the exercise price (which is zero) of the common units of the outstanding time-vesting common units for the respective period. The remaining compensation expense that was measured at the

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date of grant will be amortized on a straight-line basis over the remaining vesting period. Compensation expense relating to the other 50% of common units granted, which vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30%, will be measured and recognized if and when these events occur.

Activity relating to the common units granted pursuant to employee subscription agreements during the six month period ended July 4, 2004 is as follows:

Unvested common units outstanding as of January 4, 2004	1,482,385
Granted units	26,200
Vested units	
Forfeited units	(16,600)
Unvested common units outstanding as of July 4, 2004	1,491,985

As of July 4, 2004, there were 219,359 common units available for grant.

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by SFAS No. 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transitional requirements of SFAS No. 148 are effective for all financial statements for fiscal years ending after December 15, 2002. The application of the disclosure portion of this standard did not have any impact on our consolidated financial statements. The financial and accounting standards board recently indicated that it will require stock-based employee compensation to be recorded as a charge to earnings pursuant to a standard it is currently deliberating, which it believes will become effective during 2004. We will continue to monitor its progress on the issuance of this standard as well as evaluate our position with respect to current guidance.

12) Financial Information about Geographic Areas

Income (loss) before income taxes for the Company s domestic and foreign operations are as follows (amounts in thousands):

	Three month periods ended		Six month periods ended	
	July 4, 2004	**June 29, 2003**	**July 4, 2004**	**June 29, 2003 Restated**
Domestic	$ (1,020)	$ 2,096	$ 1,324	$ 4,697
Foreign	276	(323)	659	(210)
Total	$ (744)	$ 1,773	$ 1,983	$ 4,487

13) Restaurant Activity

In January 2003, the Company closed the Morton s steakhouse in Hong Kong Central. In August 2003, the Company closed the Morton s steakhouse in Addison, Texas. No restaurants were opened or closed during the six month period ended July 4, 2004. During July 2004, a new Morton s steakhouse opened in White Plains, New York.

14) Legal Matters and Contingencies

Since August 2002, a number of the Company s current and former employees in New York and Florida have initiated arbitrations with the American Arbitration Association in their respective states alleging that the Company has violated state and federal (New York arbitrations) and federal (Florida arbitrations) wage and hour laws regarding the sharing of tips with other employees and failure to pay for all hours worked. In general, the complainants are seeking restitution of tips, the difference between the tip credit wage and the minimum wage, payment for hours worked off the clock, liquidated damages and attorneys fees and costs. The arbitrator in the New York arbitrations has permitted the complainants to consolidate their arbitrations into one action and proceed as a collective action. The Florida complainants are also seeking to consolidate their arbitrations, but there has been no determination to date. The Company believes that the allegations are without merit and intends to contest them vigorously.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate resolution of these actions will have a material adverse effect on the Company s consolidated financial position, results of operations, liquidity and capital resources.

15) Supplemental Condensed Consolidating Financial Information

The obligations of Morton s Restaurant Group, Inc. (the Issuer) related to the 7.5% senior secured notes are fully and unconditionally guaranteed on a joint and several basis and on a senior basis by certain of the Company s wholly-owned domestic subsidiaries (the Guarantors). These guarantees are senior secured obligations of the Guarantors, subject to liens permitted under the indenture governing the 7.5% senior secured notes, rank senior in right of payment to all subordinated indebtedness of the Guarantors and rank *pari passu* in right of payment with all existing and future senior indebtedness of the Guarantors. There are no restrictions on the Company s ability to obtain cash dividends or other distributions of funds from the Guarantors, except those imposed by applicable law and certain contractual restrictions, which do not exceed 25% of consolidated net assets of any Guarantor, that are permitted under the indenture governing the 7.5% senior secured notes. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for the Issuer, domestic subsidiaries of the Company that are Guarantors and foreign subsidiaries and domestic subsidiaries of the Company that are not Guarantors (collectively, the Non-Guarantor Subsidiaries). The Company has not presented separate financial statements and other disclosures concerning the Guarantor Subsidiaries because management has determined that such information is not material to investors.

Supplemental Consolidating Balance Sheet

July 4, 2004

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 695	$ 1,074	$ 509	$	$ 2,278
Restricted cash	1,021				1,021
Marketable securities	1,741				1,741
Accounts receivable	57	2,839	146		3,042
Inventories		8,949	534		9,483
Prepaid expenses and other current assets	329	5,519	39		5,887
Deferred income taxes	3,210	3,313			6,523
Total current assets	7,053	21,694	1,228		29,975
Property and equipment, net	135	53,292	1,210		54,637
Intangible asset		92,000			92,000
Goodwill		61,552			61,552
Other assets and deferred expenses, net	8,343	3,721	247	(2,520)	9,791
Amounts due from affiliates	140,174	505		(140,679)	
	$ 155,705	$ 232,764	$ 2,685	$ (143,199)	$ 247,955

Supplemental Consolidating Balance Sheet

July 4, 2004

(unaudited)

(amounts in thousands, except share and per share amounts)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 5,131	$ 23,216	$ 1,026	$	$ 29,373
Current portion of obligations to financial institutions		497			497
Accrued income taxes	(2,307)	2,813	(459)		47
Amounts due to affiliates		140,174	505	(140,679)	
Total current liabilities	2,824	166,700	1,072	(140,679)	29,917
7.5% senior secured notes, net of unamortized discount of $14,157	90,843				90,843
Obligations to financial institutions, less current maturities		6,903			6,903
Deferred income taxes		20,471			20,471
Other liabilities	(32)	2,911	78		2,957
Total liabilities	93,635	196,985	1,150	(140,679)	151,091
Commitments and contingencies					
Stockholder s equity:					
Common stock, $0.01 par value per share. Authorized, issued and outstanding 1,000 shares					
Additional paid-in capital	97,076	2,520		(2,520)	97,076
Accumulated other comprehensive income (loss)		225	(155)		70
(Accumulated deficit) retained earnings	(35,006)	33,034	1,690		(282)
Total stockholder s equity	62,070	35,779	1,535	(2,520)	96,864
	$ 155,705	$ 232,764	$ 2,685	$ (143,199)	$ 247,955

Supplemental Consolidating Balance Sheet

January 4, 2004

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 17,911	$ (614)	$ 700	$	$ 17,997
Restricted cash	1,100				1,100
Accounts receivable	2	3,665	162		3,829
Inventories		8,511	583		9,094
Prepaid expenses and other current assets	382	4,649	38		5,069
Deferred income taxes	1,875	5,201			7,076
Total current assets	21,270	21,412	1,483		44,165
Property and equipment, net	91	52,537	1,482		54,110
Intangible asset		92,000			92,000
Goodwill		61,552			61,552
Other assets and deferred expenses, net					