Yale SCHOOL OF MANAGEMENT

YALE CASE 20-020 JULY 4, 2020

Nathan's Famous

Who Ate the Shareholder Equity?

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"Hey hotdog girl!"

Stacy Cord cringed. She knew it was Ted Dyson calling out. Dyson, who imagined himself the office wit, had nicknamed her 'hotdog girl' when Cord had started researching Nathan's Famous. Now he was swaggering over to her cubicle.

"Looks like your little stand is in a bit of trouble," Dyson said mockingly. He slapped Nathan's latest financials onto her desk. Dyson had 'helpfully' highlighted the shareholder equity line on Nathan's balance sheet. The number had gone from a positive $44 million in 2014 to a whopping negative $60 million in 2015. Dyson thankfully did not say anything else, confident that he had burst Cord's balloon.

Cord blinked. How could this have happened?

Both Cord and Dyson were analysts at the large investment firm Canner and Orange (C&O).[3] C&O made investments in medium-sized companies, sometimes taking the firms private. The firm encouraged its analysts to scan the market for interesting opportunities.

Cord had spotted Nathan's last fall. Nathan's Famous was the corporate outgrowth of a little hotdog stand that had been started in 1916 on Coney Island. Over the years, the company had become internationally famous; the brand becoming synonymous with hotdogs. Every U.S. Independence Day since 1916, Nathan's sponsored a hotdog eating contest that was broadcast globally.

The company went public in 1968 and the Handwerker family who had run the operation sold its shares in 1987. As a public company, Nathan's had delivered steady profits. The company had franchised operations to over 300 units operating in 28 states and eight foreign countries (Nathan's also owned and operated five of its own outlets). In addition, the company also sold a popular line of supermarket hotdogs. In 2014, the company had reported gross profits of nearly $11 million on revenues of $66 million.

In the fall of 2014, Cord began to look closer at the Nathan's and was considering making a presentation to C&O's investment committee. However, at the beginning of 2015, she was pulled away to work on another deal. The deal was complex and Cord had to put in long hours. She basically lost track of all her other projects and had just begun to resurface.

Now in the beginning of April 2015, Cord worried that her investment idea had been squashed. She couldn't recall any negative information about Nathan's in recent months – no product recalls or franchise closings. Indeed, the financials showed an increase in net earnings for the year. And yet, when Cord glanced at her Bloomberg terminal, she saw that Nathan's stock was plummeting. The stock was off 25% in the last couple of days.

Cord dug into the financials Dyson had left on her desk. She first wanted to get to bottom of the negative shareholder equity. What did the financials say about the $100 million swing? Was the company still viable? If so, what could investors expect in terms of future earnings and cash flows? As an investment firm that specialized in LBOs, C&O would be especially interested in the cash flows that would help finance any purchase.

Endnotes

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[3] Canner & Orange is a fictious entity.

Exhibit 1: Nathan's Famous Share Price, October 1, 2014 – March 31, 2015

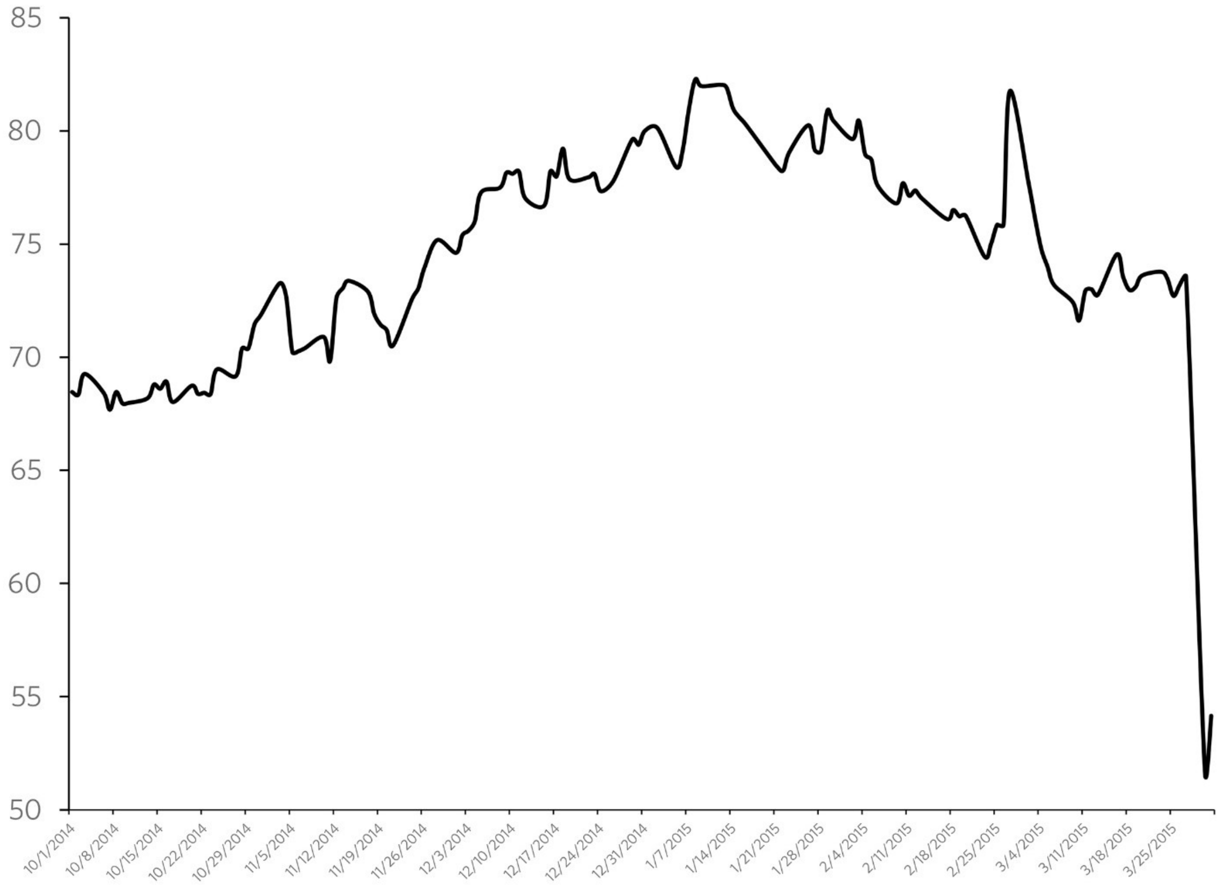

Exhibit 2: Nathan's Fiscal Year-End Financials, March 2015

CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	March 29, 2015	March 30, 2014
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	**$ 51,393**	$ 22,077
Marketable securities	**7,091**	11,187
Accounts and other receivables, net	**9,499**	7,823
Inventories	**822**	947
Prepaid expenses and other current assets (Note F)	**4,532**	3,129
Deferred income taxes	**277**	26
Total current assets	**73,614**	45,189
Property and equipment, net of accumulated depreciation of $6,946 and $7,554, respectively	**9,257**	8,970
Goodwill	**95**	95
Intangible asset	**1,353**	1,353
Other assets	**347**	528
	$ 84,666	$ 56,135
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
CURRENT LIABILITIES		
Accounts payable	**$ 5,319**	$ 4,826
Accrued expenses and other current liabilities	**6,412**	4,751
Deferred franchise fees	**278**	234
Total current liabilities	**12,009**	9,811
Long-term debt, net of unamortized debt discounts and issuance costs of $5,860 (Note K)	**129,140**	-
Other liabilities	**2,397**	1,693
Deferred income taxes	**1,028**	734
Total liabilities	**144,574**	12,238
COMMITMENTS AND CONTINGENCIES (Note M)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, $.01 par value; 30,000,000 shares authorized; 9,252,097 and 9,092,183 shares issued; and 4,604,410 and 4,482,157 shares outstanding at March 29, 2015 and March 30, 2014, respectively	**93**	91
Additional paid-in capital	**60,196**	57,578
(Accumulated deficit) retained earnings	**(63,444)**	40,963
Accumulated other comprehensive income	**47**	149
	(3,108)	98,781
Treasury stock, at cost, 4,647,687 and 4,610,026 shares at March 29, 2015 and March 30, 2014, respectively	**(56,800)**	(54,884)
Total stockholders' (deficit) equity	**(59,908)**	43,897
	$ 84,666	$ 56,135

The accompanying notes are an integral part of these statements.

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Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS
(in thousands, except share and per share amounts)

	Fifty-Two weeks ended March 29, 2015	Fifty-Two weeks ended March 30, 2014	Fifty-Three weeks ended March 31, 2013
REVENUES			
Sales	$ 75,520	$ 65,521	$ 56,656
License royalties	18,011	8,513	8,571
Franchise fees and royalties	5,581	5,718	5,842
Total revenues	99,112	79,752	71,069
COSTS AND EXPENSES			
Cost of sales	61,951	53,072	44,874
Restaurant operating expenses	3,747	3,142	2,700
Depreciation and amortization	1,253	1,157	940
General and administrative expenses	12,203	11,460	10,437
Total costs and expenses	79,154	68,831	58,951
Income from operations	19,958	10,921	12,118
Interest expense	(816)	(135)	(453)
Interest income	176	325	392
Insurance gain (Note M.4)	-	2,774	-
Impairment charge – long-term investment (Note G)	-	(400)	-
Other income, net	87	76	82
Income before provision for income taxes	19,405	13,561	12,139
Provision for income taxes	7,702	5,234	4,671
Net income	$ 11,703	$ 8,327	$ 7,468
PER SHARE INFORMATION			
Income per share:			
Basic	$ 2.61	$ 1.87	$ 1.70
Diluted	$ 2.55	$ 1.81	$ 1.63
Cash dividends declared per share	$ 25.00	$ -	$ -
Weighted average shares used in computing income per share:			
Basic	4,486,000	4,450,000	4,400,000
Diluted	4,588,000	4,605,000	4,588,000

The accompanying notes are an integral part of these statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Fifty-Two weeks ended March 29, 2015	Fifty-Two weeks ended March 30, 2014	Fifty-Three weeks ended March 31, 2013
Net income	**$ 11,703**	$ 8,327	$ 7,468
Other comprehensive loss, net of deferred income taxes:			
Unrealized losses on marketable securities	**(102)**	(180)	(168)
Other comprehensive loss	**(102)**	(180)	(168)
Comprehensive income	**$ 11,601**	$ 8,147	$ 7,300

The accompanying notes are an integral part of these statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT) EQUITY

Fifty-two weeks ended March 29, 2015, the Fifty-two weeks ended March 30, 2014 and the Fifty-three weeks ended March 31, 2013

(in thousands, except share amounts)

	Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock, at Cost Shares	Treasury Stock, at Cost Amount	Total Stockholders' Equity
Balance, March 25, 2012	8,855,263	$ 89	$ 53,396	$ 25,168	$ 497	4,491,486	$ (50,313)	$ 28,837
Shares issued in connection with share-based compensation plans	102,918	1	388	-	-	-	-	389
Withholding tax on net share settlement of share-based compensation plans	-	-	(982)	-	-	-	-	(982)
Repurchase of common stock	-	-	-	-	-	88,077	(3,085)	(3,085)
Income tax benefit on stock option exercises	-	-	1,062	-	-	-	-	1,062
Share-based compensation	-	-	627	-	-	-	-	627
Unrealized losses on available-for-sale securities, net of deferred income tax benefit of $105	-	-	-	-	(168)	-	-	(168)
Net income	-	-	-	7,468	-	-	-	7,468
Balance, March 31, 2013	8,958,181	$ 90	$ 54,491	$ 32,636	$ 329	4,579,563	$ (53,398)	$ 34,148

The accompanying notes are an integral part of these statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT) EQUITY

Fifty-two weeks ended March 29, 2015, the Fifty-two weeks ended March 30, 2014 and the Fifty-three weeks ended March 31, 2013
(in thousands, except share amounts)

	Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock, at Cost		Total Stockholders' Equity
						Shares	Amount	
Balance, March 31, 2013	8,958,181	$ 90	$ 54,491	$ 32,636	$ 329	4,579,563	$ (53,398)	$ 34,148
Shares issued in connection with share-based compensation plans	134,002	1	943	-	-	-	-	944
Withholding tax on net share settlement of share-based compensation plans	-	-	(772)	-	-	-	-	(772)
Repurchase of common stock	-	-	-	-	-	30,463	(1,486)	(1,486)
Income tax benefit on stock option exercises	-	-	2,195	-	-	-	-	2,195
Share-based compensation	-	-	721	-	-	-	-	721
Unrealized losses on available-for-sale securities, net of deferred income tax benefit of $119	-	-	-	-	(180)	-	-	(180)
Net income	-	-	-	8,327	-	-	-	8,327
Balance, March 30, 2014	9,092,183	$ 91	$ 57,578	$ 40,963	$ 149	4,610,026	$ (54,884)	$ 43,897

The accompanying notes are an integral part of these statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT) EQUITY

Fifty-two weeks ended March 29, 2015, the Fifty-two weeks ended March 30, 2014 and the Fifty-three weeks ended March 31, 2013
(in thousands, except share amounts)

	Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Treasury Stock, at Cost		Total Stockholders' (Deficit) Equity
						Shares	Amount	
Balance, March 30, 2014	**9,092,183**	**$ 91**	**$ 57,578**	**$ 40,963**	**$ 149**	**4,610,026**	**$ (54,884)**	**$ 43,897**
Shares issued in connection with share-based compensation plans	**159,914**	**2**	**880**	**-**	**-**	**-**	**-**	**882**
Withholding tax on net share settlement of share-based compensation plans	**-**	**-**	**(3,693)**	**-**	**-**	**-**	**-**	**(3,693)**
Repurchase of common stock	**-**	**-**	**-**	**-**	**-**	**37,661**	**(1,916)**	**(1,916)**
Income tax benefit on stock option exercises	**-**	**-**	**4,572**	**-**	**-**	**-**	**-**	**4,572**
Share-based compensation	**-**	**-**	**859**	**-**	**-**	**-**	**-**	**859**
Unrealized losses on available-for-sale securities, net of deferred income tax benefit of $66	**-**	**-**	**-**	**-**	**(102)**	**-**	**-**	**(102)**
Dividends declared				**(116,110)**				**(116,110)**
Net income	**-**	**-**	**-**	**11,703**	**-**	**-**	**-**	**11,703**
Balance, March 29, 2015	**9,252,097**	**$ 93**	**$ 60,196**	**$ (63,444)**	**$ 47**	**4,647,687**	**$ (56,800)**	**$ (59,908)**

The accompanying notes are an integral part of these statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

		Fifty-Two weeks ended March 29, 2015		Fifty-Two weeks ended March 30, 2014		Fifty-Three weeks ended March 31, 2013
Cash flows from operating activities:						
Net income	$	**11,703**	$	8,327	$	7,468
Adjustments to reconcile net income to net cash provided by operating activities						
Depreciation and amortization		**1,253**		1,157		940
Insurance gain		**-**		(2,774)		-
Amortization of bond premium		**164**		150		130
Amortization of debt discounts and issuance costs		**66**		-		-
Share-based compensation expense		**859**		721		627
Provision for doubtful accounts		**23**		21		15
Impairment charge – long-term investment		**-**		400		-
Deferred income taxes		**111**		1,652		497
Changes in operating assets and liabilities:						
Accounts and other receivables, net		**(2,417)**		(927)		(397)
Insurance proceeds received for business interruption claim		**718**		-		-
Inventories		**125**		99		79
Prepaid expenses and other current assets		**(1,403)**		(2,033)		298
Other assets		**181**		30		7
Accrued litigation		**-**		(5,874)		455
Accounts payable, accrued expenses and other current liabilities		**1,779**		2,329		(838)
Advances of insurance proceeds		**-**		-		130
Deferred franchise fees		**44**		(44)		155
Other liabilities		**79**		(358)		(72)
Net cash provided by operating activities		**13,285**		2,876		9,494
Cash flows from investing activities:						
Proceeds from sales and maturities of available-for-sale securities		**8,020**		2,890		2,000
Insurance proceeds received for property and equipment (Note M.4)		**-**		2,711		449
Purchase of long-term investment		**-**		-		(500)
Change in restricted cash		**-**		(135)		(455)
Purchase of property and equipment		**(1,538)**		(4,339)		(998)
Purchase of available-for-sale securities		**(4,258)**		(2,219)		-
Litigation settlement		**-**		6,009		-
Net cash provided by investing activities		**2,224**		4,917		496
Cash flows from financing activities:						
Proceeds from issuance of long-term debt		**135,000**		-		-
Debt discounts and issuance costs		**(5,926)**		-		-
Dividends paid to stockholders		**(115,110)**		-		-
Repurchase of treasury stock		**(1,916)**		(1,486)		(3,085)
Proceeds from the exercise of stock options		**880**		944		389
Income tax benefit on stock option exercises		**4,572**		2,195		1,062
Payments of withholding tax on net share settlement of share-based compensation plans		**(3,693)**		(772)		(982)
Net cash provided by (used in) financing activities		**13,807**		881		(2,616)
Net increase in cash and cash equivalents		**29,316**		8,674		7,374
Cash and cash equivalents, beginning of year		**22,077**		13,403		6,029
Cash and cash equivalents, end of year	$	**51,393**	$	22,077	$	13,403
Cash paid during the year for:						
Interest	$	**-**	$	1,099	$	-
Income taxes	$	**4,545**	$	3,457	$	2,548

The accompanying notes are an integral part of these statements.

NOTE K – LONG-TERM DEBT (continued)

There are no financial maintenance covenants associated with the Notes. The Indenture contains certain covenants limiting the Company's ability and the ability of its restricted subsidiaries (as defined in the Indenture) to, subject to certain exceptions and qualifications: (i) incur additional indebtedness; (ii) pay dividends or make other distributions on, redeem or repurchase, capital stock; (iii) make investments or other restricted payments; (iv) create or incur certain liens; (v) incur restrictions on the payment of dividends or other distributions from its restricted subsidiaries; (vi) enter into certain transactions with affiliates; (vii) sell assets; or (viii) effect a consolidation or merger. Certain Restricted Payments which may be made or indebtedness incurred by Nathan's or its Restricted Subsidiaries may require compliance with certain financial ratios.

The Indenture also contains customary events of default, including, among other things, failure to pay interest, failure to comply with agreements related to the indenture, failure to pay at maturity or acceleration of other indebtedness, failure to pay certain judgments, and certain events of insolvency or bankruptcy. Generally, if any event of default occurs, the Trustee or the holders of at least 25% in principal amount of the Notes may declare the Notes due and payable by providing notice to the Company. In case of default arising from certain events of bankruptcy or insolvency, the Notes will become immediately due and payable.

As of March 29, 2015, Nathan's was in compliance with all covenants associated with the Notes.

The finacial ratios are as follows:

Fixed Charge Coverage Ratio: the ratio of the Consolidated Cash Flow to the Fixed Charges for the relevant period, currently set at 2.0 to 1.0 in the Indenture. The Fixed Charge Coverage Ratio applies to determining whether additional Restricted Payments may be made, certain additional debt may be incurred and acquisitions may be made.

Priority Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Priority Lien to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate; currently set at 0.40 to 1.00 in the Indenture.

Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Lien on any property of Nathan's or any Guarantor to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate. The Secured Leverage Ratio under the Indenture is 3.75 to 1.00 and applies if Nathan's wants to incur additional debt on the same terms as the Notes.

The Notes are general senior secured obligations, are guaranteed by the substantially all of the Company's wholly-owned subsidiaries and rank *pari passu* in right of payment with all of the Company's existing and future indebtedness that is not subordinated, are senior in right of payment to any of the Company's existing and future subordinated indebtedness, are structurally subordinated to any existing and future indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the Notes, and are effectively junior to all existing and future indebtedness that is secured by assets other than the collateral securing the Notes.

Prior to September 15, 2017, the Company has the option to redeem up to 35% of the aggregate principal amount of the Notes at a redemption price equal to 110% of the principal amount of the Notes redeemed, plus accrued and unpaid interest and any additional interest, with the net cash proceeds of certain equity offerings.

(in thousands, except share and per share amounts)

NOTE K – LONG-TERM DEBT (continued)

The Company may redeem the Notes in whole or in part prior to September 15, 2017, at a redemption price of 100% of the principal amount of the Notes plus the Applicable Premium, plus accrued and unpaid interest. An Applicable Premium is the greater of 1% of the principal amount of the Notes; or the excess of the present value at such redemption date of (i) the redemption price of the Notes at September 15, 2017 plus (ii) all required interest payments due on the Notes through September 15, 2017 (excluding accrued but unpaid interest to the redemption date), computed using a discount rate equal to the Treasury Rate as of such redemption date plus 50 basis points; over the then outstanding principal amount of the Notes. On or after September 15, 2017, the Company may redeem some or all of the Notes at a decreasing premium over time, plus accrued and unpaid interest as follows:

YEAR	PERCENTAGE
On or after September 15, 2017 and prior to March 15, 2018	105.000%
On or after March 15, 2018 and prior to March 15, 2019	102.500%
On and after March 15, 2019	100.000%

In certain circumstances involving a change of control, the Company will be required to make an offer to repurchase all or, at the holder's option, any part, of each holder's Notes pursuant to the offer described below (the "Change of Control Offer"). In the Change of Control Offer, the Company will be required to offer payment in cash equal to 101% of the aggregate principal amount of Notes repurchased plus accrued and unpaid interest, to the date of purchase.

If the Company sells certain assets and does not use the net proceeds as required, the Company will be required to use such net proceeds to repurchase the Notes at 100% of the principal amount thereof, plus accrued and unpaid interest and additional interest penalty, if any, to the date of repurchase.

The Notes may be traded between qualified institutional buyers pursuant to Rule 144A of the Securities Act of 1933. We have recorded the Notes at cost. As of March 29, 2015, the fair value of the long-term debt was $141,835, as determined based upon review of observable pricing in secondary markets as of the last trading day of the fiscal period. Accordingly, the long-term debt is categorized as Level 2 for purposes of the fair value measurement hierarchy.