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Deals & Deal Makers: Of Burgers and Bonds: DLJ Draws Fire as Deal Sours --- AmeriServe Offering Didn't Alert Investors Of Burger King Gripes

By Paul M. Sherer

Staff Reporter of The Wall Street Journal
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What's a Burger King without enough burgers? A real headache for Burger King Corp.

In the middle of last year, some of its restaurants were running short of meat patties, pickles and giveaway toys for children as AmeriServe Food Distribution Inc. struggled to pay suppliers and make shipments to customers.

Things got so bad that in July, Burger King delivered a stern message to AmeriServe: Clean up your act, or risk losing our business. AmeriServe promised to fix the problems by Labor Day. By early September, however, "we had not seen any improvement," says Burger King's general counsel, Barry Blum.

But investors weren't told of problems with suppliers or Burger King when AmeriServe sold $200 million in junk bonds later that month. Instead, an offering memorandum by AmeriServe and its underwriter, Donaldson, Lufkin & Jenrette Inc., declared that the 37-year relationship with Burger King -- which accounted for 25% of AmeriServe's $9 billion in 1999 revenue -- was great. AmeriServe stated that it didn't know of any issues "that could reasonably be expected to result in termination of any such contracts. . . ."

That, investors now contend, was a real whopper. After months of troubles, Burger King notified AmeriServe in November that it planned to pull its business, though AmeriServe persuaded it to stick around for a few months. And on Jan. 31, just four months after the bond deal, AmeriServe filed for Chapter 11 bankruptcy protection after relations with suppliers worsened.

AmeriServe became, in the lingo of bond buyers, a rare "NCAA champion" -- it paid No Coupon At All, defaulting before its first interest payment, or coupon. The aptly named junk bonds are trading for just 18 cents on the dollar, for a loss to investors of more than $160 million.

"Investors feel snookered," says David M. Friedman, senior partner at Kasowitz, Benson, Torres & Friedman LLP, who is representing the bond buyers, "because they feel they were misled by people who were intimately involved in the company's affairs, and who should have told them more about what was going on."

It would be a black eye for any investment bank to have a client hit the skids so quickly after raising so much money. Before selling bonds, an underwriter is expected to scrutinize a company's finances and operations, and flag any major problems in the offering memorandum.

But DLJ -- Wall Street's leading junk bond underwriter -- was far more than AmeriServe's underwriter. It had warrants giving it a stake of about 30% in the company, and two DLJ managing directors sat on AmeriServe's board through last December, giving DLJ direct access to detailed data on the company's health.

Why weren't the troubles with Burger King disclosed? DLJ says that in September, it had no indication AmeriServe was in danger of losing Burger King's business, and that no word of such a threat was brought to the board. "We never had any inkling," maintains Benoit Jamar, one of the DLJ managing directors who sat on AmeriServe's board. "We probed it extensively, not just at every board meeting, but at every due diligence session we had [before] our bond deal."

Despite such assertions, the U.S. Bankruptcy Court in Wilmington, Del., has appointed an examiner to investigate allegations of fraud, misconduct or mismanagement at AmeriServe, some of them brought by creditors and former employees. Among other things, the examiner is looking into payments transferring millions of dollars out of the company in the months prior to the bankruptcy filing, including management fees paid to controlling shareholder Holberg Industries Inc. and investment banking fees paid to DLJ, people familiar with the investigation said. All told, DLJ received $4.6 million in fees for the September bond issue, $4 million for a $100 million loan the firm made in December, and $4 million for restructuring work during the period. DLJ says its fees were customary given the company's low **credit** rating.

A group of bondholders have filed a motion requesting the court's backing to investigate what DLJ knew and when it knew it. "DLJ should have, but did not, disclose the problems" of AmeriServe, the filing says. AmeriServe and its creditors "may have a number of claims against DLJ arising out of its conduct in its various roles," including "disgorgement of fees" and "breach of fiduciary duties," it adds.

The immediate triggering event for the Chapter 11 reorganization filing wasn't Burger King, but rather the suppliers who cut back sharply on **credit** to AmeriServe starting in November. AmeriServe's problems with Burger King were directly related, caused by the same service and cash-flow difficulties.

AmeriServe's former chief executive officer, John Holten, acknowledges there were substantial problems with service to Burger King in the summer of 1999. But he says AmeriServe saw those problems as things to be expected amid a difficult integration of two recently acquired firms.

"A distributor and a chain are really like a marriage," Mr. Holten says. "We are very dependent on each other. So when you're unhappy with each other, the chain tends to give the distributor some time to fix the problems."

Mr. Holten resigned as CEO after the Chapter 11 filing but remains AmeriServe's chairman and serves as chief executive of Holberg Industries, the Greenwich, Conn., firm that controls AmeriServe. The 43-year-old native of Norway entered the food-service business in 1986, when Holberg, which he cofounded that year, purchased a small Nebraska distributor. AmeriServe is now led by Ronald Rittenmeyer, who was hired in March as president and CEO.

For both AmeriServe and DLJ, the debacle could mark the end of what has been a mutually beneficial relationship. As AmeriServe's investment bank since 1993, DLJ advised a series of acquisitions and bond deals that built AmeriServe into one of the largest 15 or so private companies in the U.S as measured by revenue. The country's biggest distributor to fast-food restaurants, its clients included not just Burger King but Taco Bell, Pizza Hut, KFC, Arby's, Dairy Queen and many others.

To pay for its takeovers, AmeriServe and its holding companies loaded up on debt, most of it arranged by DLJ. By December, AmeriServe and its holding company had amassed nearly $1.5 billion in debt. That's 9.4 times its annual cash flow, double the average debt load for a leveraged-buyout company.

Integrating the acquisitions proved tough, leaving AmeriServe struggling to make deliveries, pay suppliers and bill its customers properly.

By the September bond issue, AmeriServe had been lagging in payments to its suppliers for months, and suppliers occasionally had cut off shipments.

Pilgrim's Pride Corp., which supplies chicken to Burger King through AmeriServe, says AmeriServe had fallen behind in payments since at least December 1998. By last May, AmeriServe was more than two weeks behind, prompting Pilgrim's Pride to withhold shipments several times last year. "AmeriServe was very bad" in making payments, says Richard A. Cogdill, chief financial officer of the Pittsburg, Texas, supplier.

Burger King's logbooks from mid-1999 are filled with reports from franchisees complaining about AmeriServe's late and incomplete deliveries, damaged shipments and billing problems. A summer marketing blitz by Burger King hit trouble when AmeriServe failed to deliver sufficient toy giveaways tied to the movie Wild Wild West. "We had to face that seven-year-old kid and say, 'Sorry, we didn't get the toys,' " recalls a spokeswoman for Burger King, which is a unit of Britain's Diageo PLC.

Mr. Blum and his team of officials flew to Texas on July 16 for a meeting at AmeriServe's Addison headquarters with Mr. Holten and several other directors. Backing up Burger King were officials from a purchasing cooperative for its franchises. "We gave them a very hard message that things were unacceptable, a 'we're sick and tired and we're not going to take it anymore' kind of message. . . . This was putting our entire brand at risk," Mr. Blum says.

Mr. Holten says Burger King warned AmeriServe it could lose contracts with some franchisees, but didn't threaten to pull all its business. "That meeting was nothing out of the very ordinary," he says. AmeriServe promised its service would improve.

But things continued to deteriorate after the $200 million bond issue. By November, some suppliers became increasingly worried about AmeriServe's financial position, and a number tightened up **credit**, with some demanding cash on delivery.

Duaine Kamenick, vice president of finance at dairy cooperative Foremost Farms USA in Baraboo, Wis., found AmeriServe's November financial statement on the company's Internet site. "It actually indicated rather strong negative net worth, large accumulated losses, and cash flow problems," says Mr. Kamenick. He immediately stopped shipping product unless AmeriServe's payments were up to date.

Restaurants felt the consequences of supplier cutoffs. In scattered towns and cities, Burger King restaurants ran low on supplies. On Nov. 11, Burger King sent a letter terminating its approval of AmeriServe as a distributor to its restaurants. Franchisees, which had their own individual contracts with AmeriServe, would be barred from using the distributor.

The following morning, Mr. Blum and his team flew to New York to negotiate the termination. The two sides now dispute some of what transpired.

AmeriServe pleaded with Burger King to rescind the termination. Burger King agreed -- on the condition that AmeriServe let all Burger King franchisees out of their contracts as of May 15. "If you can turn it around by May 15, no one is going to leave," Mr. Blum says he told AmeriServe. "But . . . May 15 is as far as we're going to go." At the time, many Burger King franchisees had about four years left in their five-year contracts with AmeriServe.

DLJ and Mr. Holten claim that by the end of the meeting they considered the problems with Burger King to be solved; they say Burger King sent its letter of termination purely to protect itself in case AmeriServe sought bankruptcy-court protection. Burger King "confirmed a thousand times . . . they had no intention whatsoever to take any business away," Mr. Holten says.

In a Nov. 23 SEC filing, AmeriServe made no mention of the Burger King termination letter. (It wasn't until March 31 that AmeriServe disclosed troubles with Burger King.)

In December, both DLJ and Holberg Industries put new money into AmeriServe, part of $191.1 million AmeriServe raised from lenders and investors that month, which they say demonstrates their confidence in the company. Holberg invested $30 million in new equity, while DLJ made a $100 million loan with the intention of syndicating it to other investors, though AmeriServe filed for Chapter 11 protection before DLJ was able to do so.

Because its loan is senior to the junk bonds, DLJ is in line to recoup all of its $100 million loan to AmeriServe before the junk-bond holders get a penny. A DLJ spokeswoman says, "AmeriServe is being carried on the firm's books at a value that we deem appropriate, and we're not disclosing that value."

A day or two before DLJ made the $100 million loan, DLJ's Mr. Jamar says he called Burger King's vice president of finance, Steve Pattison, and was assured Burger King had no intention of pulling its business. "I feel he certainly misled us," Mr. Jamar says. "We would not have made the $100 million loan if we had had any inkling Burger King was about to take away some of its business."

Mr. Blum denies Burger King made such assurances either in November or December. On April 12, Burger King announced it was ending AmeriServe's agreements to supply 5,900 Burger King restaurants as of July, prompting AmeriServe to lay off 25% of its 6,000 employees. Yesterday, Burger King announced it had agreed with AmeriServe to make the transition to new distributors by July 17.

According to DLJ, only $31.1 million of the $191.1 million AmeriServe raised in December immediately went to pay off suppliers, as suppliers say they were told it would be; instead, the bulk of the proceeds from both the September and December deals went to pay down a bank loan and for general corporate purposes. Among those: a stream of payments from AmeriServe to Holberg Industries in the weeks before the bankruptcy filing. Holberg increased the 1999 management fee it charged AmeriServe to $5 million from $4 million, and was prepaid $5 million for the 2000 management fee. Mr. Holten says the fees were approved under AmeriServe's bank agreements, and says Holberg put more into AmeriServe during that time than it took out.

It could take months or longer for the bankruptcy proceedings to be resolved, but creditors are bracing for the worst. Because the roughly $2 billion in claims against AmeriServe far exceeds its assets -- which creditors think could be worth as little as $300 million -- creditors "are going to take some big haircuts on this," notes one person involved in the bankruptcy workout.

A Whopper of a Tale

Tracing AmeriServe's troubles with Burger King and suppliers, and the consequences for the company's junk bond issued in September.

-- July 16, 1999: Burger King warns AmeriServe it has `grave concerns' about the food distributor's ability to perform.

-- Sept. 24: AmeriServe sells $200 million in junk bonds, doesn't disclose Burger King troubles, says it has among the best relationships with its customers of any distributor.

-- November: Suppliers cut back on **credit**, restaurants run short of supplies.

-- Nov. 11: Burger King terminates AmeriServe's approval as distributor.

-- Nov. 12: Burger King revokes termination, AmeriServe agrees to let Burger King franchisee contracts expire May 15.

-- Nov. 23: AmeriServe 8-K filing to SEC doesn't disclose Burger King contract changes.

-- January 2000: Suppliers fear AmeriServe bankruptcy filing, tighten **credit** further.

-- Jan. 31: AmeriServe files for Chapter 11bankruptcy protection.

-- April 12: AmeriServe announces its Burger King relationship will end in July.

Sources: WSJ research, Tradeline.com

Company	All Companies
Subject	All Subjects
Industry	All Industries
Region	All Regions
Language	English