CARROLS RESTAURANT GROUP, INC.
Form 10-Q
May 14, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended April 1, 2007

OR

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

Commission File Number: 001-33174

CARROLS RESTAURANT GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**16-1287774** **(I.R.S. Employer Identification No.)**
968 James Street **Syracuse, New York** **(Address of principal executive office)**	**13203** **(Zip Code)**

Registrant s telephone number, including area code: (315) 424-0513

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	Name on each exchange on which registered:
Common Stock, Carrols Restaurant Group, Inc., par value $.01 per share	The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Commission File Number: 001-06553

CARROLS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**16-0958146**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
968 James Street Syracuse, New York	**13203**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number including area code: (315) 424-0513

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

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Carrols Corporation meets the conditions set forth in General Instruction H(1)(A) and (B) of Form 10-Q and is therefore filing this form with reduced disclosure format pursuant to General Instruction H(2) of Form 10-Q.

Indicate by check mark whether either of the registrants (1) have 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 registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, or non-accelerated filers. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act, (Check one):

Large accelerated filers ¨ Accelerated filers ¨ Non-accelerated filers x

Indicate by check mark whether either of the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act) Yes ¨ No x

As of May 3, 2007, Carrols Restaurant Group, Inc. had 21,550,827 shares of its common stock, $.01 par value outstanding. As of May 3, 2007, all outstanding equity securities of Carrols Corporation, which consisted of 10 shares of its common stock, were owned by Carrols Restaurant Group, Inc.

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CARROLS RESTAURANT GROUP, INC.

FORM 10-Q

QUARTER ENDED MARCH 31, 2007

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PART I FINANCIAL INFORMATION

ITEM 1 INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except share and per share amounts)

(Unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,283	$ 3,939
Trade and other receivables	4,174	5,364
Inventories	4,523	4,677
Prepaid rent	3,711	4,130
Prepaid expenses and other current assets	7,504	5,367
Refundable income taxes		2,806
Deferred income taxes	4,539	4,539
Total current assets	26,734	30,822
Property and equipment, net	188,545	182,742
Franchise rights, net (Note 4)	82,464	83,268
Goodwill (Note 4)	124,934	124,934
Intangible assets, net (Note 4)	1,102	1,175
Franchise agreements, at cost less accumulated amortization of $5,571 and $5,431, respectively	5,714	5,793
Deferred income taxes	11,136	11,136
Other assets	12,370	12,989
Total assets	$ 452,999	$ 452,859
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Current portion of long-term debt (Note 5)	$ 218	$ 2,477
Accounts payable	20,372	17,860
Accrued interest	3,835	7,861
Accrued payroll, related taxes and benefits	14,950	18,445
Accrued income taxes payable	211	
Accrued real estate taxes	2,982	4,102
Other liabilities	12,299	10,623
Total current liabilities	54,867	61,368
Long-term debt, net of current portion (Note 5)	301,941	297,432
Lease financing obligations (Note 9)	58,701	58,571
Deferred income sale-leaseback of real estate	31,083	31,391
Accrued postretirement benefits (Note 8)	6,519	6,370
Other liabilities (Note 7)	23,739	23,494
Total liabilities	476,850	478,626
Commitments and contingencies (Note 12)		

Stockholders deficit:		
Preferred stock, par value $.01; authorized 20,000,000 shares, issued and outstanding none		
Voting common stock, par value $.01; authorized 100,000,000 shares, issued and outstanding 21,550,827 shares at both dates	216	216
Additional paid-in capital	(2,769)	(3,108)
Accumulated deficit	(20,156)	(21,733)
Accumulated other comprehensive loss	(1,001)	(1,001)
Treasury stock, at cost	(141)	(141)
Total stockholders deficit	(23,851)	(25,767)
Total liabilities and stockholders deficit	$ 452,999	$ 452,859

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2007 AND 2006

(In thousands of dollars, except shares and per share amounts)

(Unaudited)

	2007	2006
Revenues:		
Restaurant sales	$ 187,866	$ 182,213
Franchise royalty revenues and fees	337	330
Total revenues	188,203	182,543
Costs and expenses:		
Cost of sales	52,557	51,913
Restaurant wages and related expenses	55,948	53,662
Restaurant rent expense	10,679	9,020
Other restaurant operating expenses	27,684	26,448
Advertising expense	8,535	6,912
General and administrative (including stock-based compensation expense of $318 and $0 respectively)	13,146	12,374
Depreciation and amortization	7,691	8,317
Impairment losses (Note 3)		224
Other income (Note 10)	(347)	
Total operating expenses	175,893	168,870
Income from operations	12,310	13,673
Interest expense	8,356	11,389
Loss on extinguishment of debt	1,485	
Income before income taxes	2,469	2,284
Provision for income taxes (Note 6)	892	759
Net income	$ 1,577	$ 1,525
Basic and diluted net income per share (Note 13)	$ 0.07	$ 0.10
Basic weighted average common shares outstanding (Note 13)	21,550,827	15,897,783
Diluted weighted average common shares outstanding (Note 13)	21,558,382	15,897,783

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED MARCH 31, 2007 AND 2006

(In thousands of dollars)

(Unaudited)

	2007	2006
Cash flows provided from operating activities:		
Net income	$ 1,577	$ 1,525
Adjustments to reconcile net income to net cash provided from operating activities:		
Gain on disposals of property and equipment	(121)	(35)
Stock-based compensation expense	355	
Depreciation and amortization	7,691	8,317
Amortization of deferred financing costs	335	385
Amortization of unearned purchase discounts	(539)	(540)
Amortization of deferred gains from sale-leaseback transactions	(488)	(147)
Impairment losses		224
Accretion of interest on lease financing obligations	130	78
Deferred income taxes	3,016	(336)
Loss on extinguishment of debt	1,485	
Changes in other operating assets and liabilities	(6,954)	(2,204)
Net cash provided from operating activities	6,487	7,267
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(8,361)	(6,518)
Restaurant remodeling	(1,218)	(1,678)
Other restaurant capital expenditures	(1,111)	(1,445)
Corporate and restaurant information systems	(191)	(477)
Total capital expenditures	(10,881)	(10,118)
Properties purchased for sale-leaseback	(1,633)	(1,655)
Proceeds from sale-leaseback transactions	2,473	9,413
Proceeds from sales of other properties	979	
Net cash used for investing activities	(9,062)	(2,360)
Cash flows provided from (used for) financing activities:		
Repayment of term loans under prior credit facility	(118,400)	
Borrowings on revolving credit facility	11,200	
Repayments on revolving credit facility	(10,500)	
Proceeds from new senior credit facility	120,000	
Scheduled principal payments on term loans		(550)
Principal pre-payments on term loans		(8,500)
Principal payments on capital leases	(137)	(103)
Expenses from initial public offering	(16)	
Financing costs associated with issuance of debt	(1,228)	

Net cash provided from (used for) financing activities		919		(9,153)
Net decrease in cash and cash equivalents		(1,656)		(4,246)
Cash and cash equivalents, beginning of period		3,939		9,331
Cash and cash equivalents, end of period	$	2,283	$	5,085
Supplemental disclosures:				
Interest paid on long-term debt	$	10,582	$	11,062
Interest paid on lease financing obligations	$	1,335	$	2,667
Increase (decrease) in accruals for capital expenditures	$	3,065	$	(151)
Income taxes refunded	$	(2,122)	$	(810)

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of dollars except share and per share amounts)

1. Basis of Presentation

Basis of Consolidation. The unaudited consolidated financial statements presented herein include the accounts of Carrols Restaurant Group, Inc. (Carrols Restaurant Group or the Company) and its wholly-owned subsidiary Carrols Corporation (Carrols). Carrols Restaurant Group is a holding company and conducts all of its operations through Carrols and its wholly-owned subsidiaries. Unless the context otherwise requires, Carrols Restaurant Group, Carrols and the direct and indirect subsidiaries of Carrols are collectively referred to as the Company. All intercompany transactions have been eliminated in consolidation.

The difference between the consolidated financial statements of Carrols Restaurant Group and Carrols is primarily due to additional rent expense of approximately $6 per year for Carrols Restaurant Group and the composition of stockholders deficit.

Business Description. At March 31, 2007 the Company operated, as franchisee, 327 quick-service restaurants under the trade name Burger King in 12 Northeastern, Midwestern and Southeastern states. At March 31, 2007, the Company also owned and operated 77 Pollo Tropical restaurants of which 74 were located in Florida and three were located in the New York City metropolitan area, two of which were located in northern New Jersey and one of which was located in Brooklyn, New York and franchised a total of 27 Pollo Tropical restaurants; consisting of 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At March 31, 2007, the Company owned and operated 141 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico and one in Georgia.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to December our affiliates would be willing to purchase your notes in any secondary market (if any exists) at any time. The value of your notes at any time after issuance will vary based on many factors that cannot be predicted with accuracy, including the performance of the Gold Spot Price, our creditworthiness and changes in market conditions.

- A trading market is not expected to develop for the notes. Neither we nor MLPF&S is obligated to make a market for, or to repurchase, the notes. There is no assurance that any party will be willing to purchase your notes at any price in any secondary market.
- Our business activities as a full service financial institution, including our commercial and investment banking activities, our hedging and trading activities (including trades in gold and related futures contracts) and any hedging and trading activities we engage in for our clients' accounts, may affect the market value and return of the notes and may create conflicts of interest with you.

Ownership of the notes will not entitle you to any rights with respect to gold or any related futures contracts.
Suspensions or disruptions of trading in gold and related futures contracts may adversely affect the value of the notes.
The notes will not be regulated by the U.S. Commodity Futures Trading Commission.
There may be potential conflicts of interest involving the calculation agent, which is an affiliate of ours. We have the right to appoint and remove the calculation agent.
The U.S. federal income tax consequences of the notes are uncertain, and may be adverse to a holder of the notes. See Summary Tax Consequences below and U.S. Federal Income Tax Summary beginning on page PS-27 of product supplement COMM ARN-1.

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Linked to the Gold Spot Price, due August , 2017
Additional Risk Factors

There are risks associated with investing in gold or gold-linked notes.

The Gold Spot Price will be derived from a physically settled, electronic and tradeable auction process. Certain features of U.S. futures markets are not present in the context of such auction process. For example, there are no daily price limits, which would otherwise restrict the extent of daily fluctuations in the prices of the commodities in such markets. In a declining market, therefore, it is possible that prices would continue to decline without limitation within a trading day or over a period of trading days. Gold prices are subject to volatile price movements over short periods of time and are affected by numerous factors. These include economic factors, including the structure of and confidence in the global monetary system, expectations of the future rate of inflation, the relative strength of, and confidence in, the U.S. dollar (the currency in which the price of gold is generally quoted), interest rates and gold borrowing and lending rates, and global or regional economic, financial, political, regulatory, judicial, or other events. Gold prices may also be affected by industry factors such as industrial and jewelry demand, lending, sales and purchases of gold by the official sector, including central banks and other governmental agencies and multilateral institutions which hold gold, levels of gold production and production costs, and short-term changes in supply and demand because of trading activities in the gold market. It is not possible to predict the aggregate effect of all or any combination of these factors.

The market value of the notes may be affected by price movements in distant-delivery futures contracts associated with the Gold Spot Price.

The price movements in the Gold Spot Price may not be reflected in the market value of the notes. If you are able to sell your notes, the price you receive could be affected by changes in the values of futures contracts for gold that have more distant delivery dates than the Gold Spot Price. The prices for these distant-delivery futures contracts may not increase to the same extent as the Gold Spot Price, or may decrease to a greater extent, which may adversely affect the value of the notes.

Changes in the methodology used to calculate the Gold Spot Price or changes in laws or regulations may affect the value of the notes.

As discussed in The Gold Spot Price below, the process used by the ICE Benchmark Administration (the IBA) for setting the Gold Spot Price during the term of the notes began in 2015. Accordingly, the levels of the Gold Spot Price during the term of the notes, including on the calculation day, may vary from the historical levels of the Gold Spot Price, and may be lower than they would have been in the absence of this change.

The IBA may further adjust the determination of the Gold Spot Price in a way that adversely affects the value of the notes, and has no obligation to consider your interests. Any change of this kind could cause a decrease in the Gold Spot Price, which would adversely affect the value of the notes. In addition, the price of gold could be adversely affected by the promulgation of new laws or regulations or by the reinterpretation of existing laws or regulations (including, without limitation, those relating to taxes and duties on commodities or commodity components) by one or more governments, governmental agencies or instrumentalities, courts, or other official bodies. Any event of this kind could adversely affect the Gold Spot Price and, as a result, could adversely affect the value of the notes.

Other Terms of the Notes

The provisions of this section supersede and replace the definition of Market Disruption Event set forth in product supplement COMM ARN-1.

Market Disruption Event

A Market Disruption Event means any of the following events, as determined by the calculation agent:

(A) the suspension of or material limitation on trading in gold, or futures contracts or options related to gold, on the Relevant Market (as defined below);

(B) the failure of trading to commence, or permanent discontinuance of trading, in gold, or futures contracts or options related to gold, on the Relevant Market;

(C) the failure of the IBA (as defined above) to calculate or publish the Gold Spot Price for that day; or

(D) any other event, if the calculation agent determines in its sole discretion that the event materially interferes with the issuer's ability or the ability of any of the issuer's affiliates to unwind all or a material portion of a hedge that the issuer or the issuer's affiliates have effected or may effect as to the notes.

For the purpose of determining whether a Market Disruption Event has occurred:

(A) a limitation on the hours in a trading day and/or number of days of trading will not constitute a Market Disruption Event if it results from an announced change in the regular trading hours of the Relevant Market; and

(B) a suspension of or material limitation on trading in the Relevant Market will not include any time when trading is not conducted or prices are not quoted by the IBA in the Relevant Market under ordinary circumstances.

Relevant Market means the market in London on which the IBA, or any successor thereto, quotes prices for the buying and selling of gold, or if such market is no longer the principal trading market for gold or options or futures contracts for gold, such other exchange or principal trading market for gold as determined by the calculation agent which serves as the source of prices for gold, and any principal exchanges where options or futures contracts on gold are traded.

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Linked to the Gold Spot Price, due August , 2017

The Gold Spot Price

The Gold Spot Price is a benchmark price used in the markets where gold is sold for U.S. dollars and delivered immediately. It measures the spot price of gold in U.S. dollars per troy ounce.

Until March 2015, the Gold Spot Price was determined at 3:00 p.m., London time by five market-making members of the London Bullion Market Association. During this period, these members met by telephone each London business day at 3:00 p.m. to determine the Gold Spot Price. The five members are the Bank of Nova Scotia-ScotiaMocatta, Barclays Bank Plc, Deutsche Bank AG, HSBC Bank USA, N.A., and Société Générale, collectively referred to as the London Gold Market Fixing Ltd. The Gold Spot Price is currently published by Bloomberg, L.P. under the symbol GOLDLNPM.

Commencing on March 20, 2015, the manner in which the Gold Spot Price has been determined in recent years as described above (also known as the P.M. Gold Fixing Price) was discontinued and replaced by the LBMA Gold Price. The IBA became the administrator for determining the LBMA Gold Price. The IBA provides the auction platform and methodology, as well as overall independent administration and governance for the LBMA Gold Price.

The IBA hosts an electronic auction process for the LBMA Gold Price. The auction is based on anonymous bids and offers that are published on-screen and in real-time, and conducted in U.S. dollars. The LBMA Gold Price is set twice daily at 10:30 a.m. and 3:00 p.m., London time, on each business day, with the Gold Spot Price being determined at 3:00 p.m. The Bloomberg symbol for the Gold Spot Price was unchanged as a result of these changes.

Additional information about the fixing of the LBMA Gold Price may be found at www.lbma.org.uk. We are not incorporating by reference the website or any material it includes in this term sheet.

An investment in the notes does not entitle you to any ownership interest, either directly or indirectly, in gold or in any gold transaction traded on the London bullion market. All references to the LBMA Gold Price are used with the permission of ICE Benchmark Administration Limited and have been provided for informational purposes only. ICE Benchmark Administration Limited accepts no liability or responsibility for the accuracy of the LBMA Gold Prices or the notes.

The following graph shows the daily historical performance of the Gold Spot Price in the period from January 1, 2008 through April 26, 2016. We obtained this historical data from Bloomberg L.P. We have not independently verified the accuracy or completeness of the information obtained from Bloomberg L.P. On April 26, 2016, the Gold Spot Price was 1,241.70.

Historical Performance of the Gold Spot Price

This historical data on the Gold Spot Price is not necessarily indicative of the future performance of the Gold Spot Price or what the value of the notes may be. Any historical upward or downward trend in the Gold Spot Price during any period set forth above is not an indication that the Gold Spot Price is more or less likely to increase or decrease at any time over the term of the notes.

Before investing in the notes, you should consult publicly available sources for the levels and trading pattern of the Gold Spot Price.

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Linked to the Gold Spot Price, due August , 2017
Supplement to the Plan of Distribution; Conflicts of Interest

Under our distribution agreement with MLPF&S, MLPF&S will purchase the notes from us as principal at the public offering price indicated on the cover of this term sheet, less the indicated underwriting discount.

MLPF&S, a broker-dealer subsidiary of BAC, is a member of the Financial Industry Regulatory Authority, Inc. (FINRA) and will participate as selling agent in the distribution of the notes. Accordingly, offerings of the notes will conform to the requirements of Rule 5121 applicable to FINRA members. MLPF&S may not make sales in this offering to any of its discretionary accounts without the prior written approval of the account holder.

We may deliver the notes against payment therefor in New York, New York on a date that is greater than three business days following the pricing date. Under Rule 15c6-1 of the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, if the initial settlement of the notes occurs more than three business days from the pricing date, purchasers who wish to trade the notes more than three business days prior to the original issue date will be required to specify alternative settlement arrangements to prevent a failed settlement.

The notes will not be listed on any securities exchange. In the original offering of the notes, the notes will be sold in minimum investment amounts of 100 units. If you place an order to purchase the notes, you are consenting to MLPF&S acting as a principal in effecting the transaction for your account.

MLPF&S may repurchase and resell the notes, with repurchases and resales being made at prices related to then-prevailing market prices or at negotiated prices, and these will include MLPF&S's trading commissions and mark-ups. MLPF&S may act as principal or agent in these market-making transactions; however, it is not obligated to engage in any such transactions. At MLPF&S's discretion, for a short, undetermined initial period after the issuance of the notes, MLPF&S may offer to buy the notes in the secondary market at a price that may exceed the initial estimated value of the notes. Any price offered by MLPF&S for the notes will be based on then-prevailing market conditions and other considerations, including the performance of the Gold Spot Price and the remaining term of the notes. However, neither we nor any of our affiliates is obligated to purchase your notes at any price, or at any time, and we cannot assure you that we or any of our affiliates will purchase your notes at a price that equals or exceeds the initial estimated value of the notes.

The value of the notes shown on your account statement will be based on MLPF&S's estimate of the value of the notes if MLPF&S or another of our affiliates were to make a market in the notes, which it is not obligated to do. That estimate will be based upon the price that MLPF&S may pay for the notes in light of then-prevailing market conditions and other considerations, as mentioned above, and will include transaction costs. At certain times, this price may be higher than or lower than the initial estimated value of the notes.

An investor's household, as referenced on the cover of this term sheet, will generally include accounts held by any of the following, as determined by MLPF&S in its discretion and acting in good faith based upon information then available to MLPF&S:

- the investor's spouse (including a domestic partner), siblings, parents, grandparents, spouse's parents, children and grandchildren, but excluding accounts held by aunts, uncles, cousins, nieces, nephews or any other family relationship not directly above or below the individual investor;
- a family investment vehicle, including foundations, limited partnerships and personal holding companies, but only if the beneficial owners of the vehicle consist solely of the investor or members of the investor's household as described above; and
- a trust where the grantors and/or beneficiaries of the trust consist solely of the investor or members of the investor's household as described above; provided that, purchases of the notes by a trust generally cannot be aggregated together with any purchases made by a trustee's personal account.

Purchases in retirement accounts will not be considered part of the same household as an individual investor's personal or other non-retirement account, except for individual retirement accounts (IRAs), simplified employee pension plans (SEPs), savings incentive match plan for employees (SIMPLEs), and single-participant or owners only accounts (i.e., retirement accounts held by self-employed individuals, business owners or partners with no employees other than their spouses).

Please contact your Merrill Lynch financial advisor if you have any questions about the application of these provisions to your specific circumstances or think you are eligible.

Accelerated Return Notes®
Linked to the Gold Spot Price, due August , 2017
Structuring the Notes

The notes are our debt securities, the return on which is linked to the performance of the Gold Spot Price. As is the case for all of our debt securities, including our market-linked notes, the economic terms of the notes reflect our actual or perceived creditworthiness at the time of pricing. In addition, because market-linked notes result in increased operational, funding and liability management costs to us, we typically borrow the funds under these notes at a rate that is more favorable to us than the rate that we might pay for a conventional fixed or floating rate debt security. This rate, which we refer to in this term sheet as our internal funding rate, is typically lower than the rate we would pay when we issue conventional fixed or floating rate debt securities. This generally relatively lower internal funding rate, which is reflected in the economic terms of the notes, along with the fees and charges associated with market-linked notes, typically results in the initial estimated value of the notes on the pricing date being less than their public offering price.

At maturity, we are required to pay the Redemption Amount to holders of the notes, which will be calculated based on the performance of the Gold Spot Price and the $10 per unit principal amount. In order to meet these payment obligations, at the time we issue the notes, we may choose to enter into certain hedging arrangements (which may include call options, put options or other derivatives) with MLPF&S or one of its affiliates. The terms of these hedging arrangements are determined by seeking bids from market participants, including MLPF&S and its affiliates, and take into account a number of factors, including our creditworthiness, interest rate movements, the volatility of the Gold Spot Price, the tenor of the notes and the tenor of the hedging arrangements. The economic terms of the notes and their initial estimated value depend in part on the terms of these hedging arrangements.

MLPF&S has advised us that the hedging arrangements will include a hedging related charge of approximately $0.075 per unit, reflecting an estimated profit to be credited to MLPF&S from these transactions. Since hedging entails risk and may be influenced by unpredictable market forces, additional profits and losses from these hedging arrangements may be realized by MLPF&S or any third party hedge providers.

For further information, see Risk Factors—General Risks Relating to ARNs beginning on page PS-6 and Use of Proceeds on page PS-16 of product supplement COMM ARN-1.

Summary Tax Consequences

You should consider the U.S. federal income tax consequences of an investment in the notes, including the following:

- There is no statutory, judicial, or administrative authority directly addressing the characterization of the notes.
- You agree with us (in the absence of an administrative determination, or judicial ruling to the contrary) to characterize and treat the notes for all tax purposes as a single financial contract with respect to the Gold Spot Price.
- Under this characterization and tax treatment of the notes, a U.S. Holder (as defined beginning on page 99 of the prospectus) generally will recognize capital gain or loss upon maturity or upon a sale or exchange of the notes prior to maturity. This capital gain or loss generally will be long-term capital gain or loss if you held the notes for more than one year.
- No assurance can be given that the IRS or any court will agree with this characterization and tax treatment.

You should consult your own tax advisor concerning the U.S. federal income tax consequences to you of acquiring, owning, and disposing of the notes, as well as any tax consequences arising under the laws of any state, local, foreign, or other tax jurisdiction and the possible effects of changes in U.S. federal or other tax laws. You should review carefully the discussion under the section entitled U.S. Federal Income Tax Summary beginning on page PS-27 of product supplement COMM ARN-1.

Where You Can Find More Information

We have filed a registration statement (including a product supplement, a prospectus supplement, and a prospectus) with the SEC for the offering to which this term sheet relates. Before you invest, you should read the Note Prospectus, including this term sheet, and the other documents that we have filed with the SEC, for more complete information about us and this offering. You may get these documents without cost by visiting EDGAR on the SEC website at www.sec.gov. Alternatively, we, any agent, or any dealer participating in this offering will arrange to send you these documents if you so request by calling MLPF&S toll-free at 1-800-294-1322.

Accelerated Return Notes®
Linked to the Gold Spot Price, due August , 2017
Market-Linked Investments Classification

MLPF&S classifies certain market-linked investments (the Market-Linked Investments) into categories, each with different investment characteristics. The following description is meant solely for informational purposes and is not intended to represent any particular Enhanced Return Market-Linked Investment or guarantee any performance.

Enhanced Return Market-Linked Investments are short- to medium-term investments that offer you a way to enhance exposure to a particular market view without taking on a similarly enhanced level of market downside risk. They can be especially effective in a flat to moderately positive market (or, in the case of bearish investments, a flat to moderately negative market). In exchange for the potential to receive better-than market returns on the linked asset, you must generally accept market downside risk and capped upside potential. As these investments are not market downside protected, and do not assure full repayment of principal at maturity, you need to be prepared for the possibility that you may lose all or part of your investment.

Accelerated Return Notes® and ARNs® are our registered service marks.