

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION**

IN RE:	§	
	§	
SCHLOTZSKY’S, INC., et al.,	§	CHAPTER 11
	§	
Debtors.	§	Case No. 04-54504 (lmc)
	§	Jointly Administered

NOTICE TO EQUITY SECURITY HOLDERS AND CREDITORS

Schlotsky’s, Inc., et al., each a debtor and debtor-in-possession (collectively, “Schlotsky’s” or the “Debtors”), submits this Notice to Equity Security Holders and Creditors (the “Notice”).

1. On November 18, 2004 the Debtors filed their:

Amended Motion for Orders (A) Approving Auction Procedures in Connection with the Proposed Sale of Substantially All of the Debtors' Assets and (B)(i) Authorizing and Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims and Encumbrances, (ii) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases, and (iii) Granting Related Relief (the “Amended 363/365 Motion”).

2. By this Notice, the Debtors are providing notice to the equity security holders and Creditors of the filing of the Amended 363/365 Motion and the requested hearing on the proposed sale of all or substantially all of the Debtors’ assets pursuant to Federal Rule of Bankruptcy Procedure 2002(d).

3. Complete copies of the Amended 363/365 Motion and all Exhibits referenced in this Notice may be obtained on the Debtors’ website at www.haynesboone.com/schlotskys or by calling 214-651-5905 and leaving a detailed message of your request.

SUMMARY OF THE MOTION

4. Since the June 2004 decision by the Board of Directors of the Debtors to replace the existing Chief Executive Officer, the Debtors have been engaged in a thorough analysis of their operations and finances. In consultation with management and the Debtors’ financial advisors, Trinity

Capital, LLC, the Board of Directors considered various avenues to address the Debtors' deteriorating financial situation. After due deliberation, the Debtors concluded that a sale of substantially all of their assets (the "Sale Assets") would most likely generate the greatest value for the Debtors' creditors. Since approximately mid-July 2004, the Debtors and their advisors have provided access to company information and personnel to a number of entities who had indicated an interest and a financial capability to acquire the Sale Assets. A number of these persons continue to actively investigate a purchase of the Sale Assets. Debtors have concluded that an auction (herein so called) of the Sale Assets will most likely produce the highest and best bid for the Sale Assets and thus create the greatest value for creditors and other parties in interest.

5. At a hearing on November 24, 2004, the Court granted part of the relief requested in the Amended 363/365 Motion. The Court entered an order (the "Auction Procedures Order"),

- i. establishing and approving auction procedures and requirements for interested parties to submit bids, other than credit bids made pursuant to 11 U.S.C. § 363(k);
- ii. scheduling a hearing (the "Sale Hearing") to consider approval of the proposed sale to the highest and best bidder at the Auction;
- iii. approving the form and manner of notice of the sale contemplated by this Notice and the Amended 363/365 Motion, the Asset Purchase Agreement and the related relief requested therein; and
- iv. and providing that objections, if any, to the relief requested in the Amended 363/365 Motion shall (a) be in writing, (b) comply with the Federal Rules of Bankruptcy Procedure and the Local Bankruptcy Rules of this Court, (c) set forth the names of the person objecting, the nature and amount of any claim or interest alleged by such claimant against the Debtors' estates or properties, (d) state with particularity the legal and factual basis for such objection, and (e) be filed with the Clerk of the Bankruptcy Court with a copy delivered to Chambers and a copy thereof served upon (i) Haynes and Boone, LLP, counsel to the Debtors, 901 Main Street, Suite 3100, Dallas, Texas 75202-3789, Attn: Robert Albergotti; (ii) Winstead Sechrest & Minick, counsel to the Official Committee of Unsecured Creditors, 401 Congress Ave., Suite 2100, Austin, TX 78701, Attn: Berry Spears, Esq., (iii) the United States Trustee, and (iv) counsel to the Buyer, such that all objections are received and filed not later than 9:00 a.m., Central Time, on December 8, 2004.

6. At a hearing to be held at 10:30 a.m., December 8, 2004, the Debtors will request the Court enter an order (the "Sale Order"),

- i. authorizing the sale of the Sale Assets to the highest and best bidder free and clear of all liens, claims and encumbrances;
- ii. finding, determining and approving the Cure Amount identified by Debtors on **Exhibit C** of the Amended 363/365 Motion;
- iii. authorizing the assumption and assignment of certain executory contracts and unexpired leases to the Buyer in accordance with the Asset Purchase Agreement; and
- iv. authorizing the Debtors to take any and all other actions necessary to consummate the proposed transactions.

OVERVIEW OF PROPOSED TRANSACTION

7. In general, the transaction contemplated by the Auction includes, among other things, the sale of all right, title and interest of the Debtors in the Sale Assets, plus the assumption of certain specified liabilities. Below is a summary of the key terms:

- a. **Purchased Assets.** Pursuant to Section 1.2 of the proposed asset purchase agreement (herein so called), the assets to be sold consist of substantially all of the assets of the Debtors including (1) the Schlotzsky's System and the Concept; (2) Sellers' interest in and to the Assumed Agreements designated on Schedule 1.2(b) (the "**Assumed Agreements**"); (3) Certain Owned Real Property listed on Schedule 1.2(c); (4) Certain equipment and leasehold improvements installed in the Leased Real Property and the Subleases, and all of the Equipment listed on Schedule 1.2(b); (5) All transferable Licenses and all rights to use existing Restaurant telephone numbers and rights arising under Equipment warranties; and (6) All Inventory, Intellectual Property, Accounts Receivable and notes receivable of the Business and all goodwill.
- b. **Purchase Price.** As full consideration for the Assets, the Buyer shall pay to the Debtors at closing, a cash purchase price of not less than \$25,000,000 (subject to a customary working capital adjustment), plus the assumption of certain liabilities as set forth in the Purchase Agreement (the "**Assumed Liabilities**").
- c. **Assumption and Assignment of Contracts; Cure Costs.** Pursuant to Section 2.6 of the Asset Purchase Agreement, the Sellers will seek to assume and assign to Buyer the Assumed Agreements identified on Schedule 1.2(b), and the Sale Order shall authorize such assumption and assignment.
- d. **Closing.** Consummation of the transactions contemplated by the Asset Purchase Agreement shall occur on or before December 31, 2004 (the "**Closing Date**"), at the offices of Schlotzsky's, Inc., 203 Colorado Street, Suite 600, Austin, Texas, 78701, or at such time and place as the Buyer and the Sellers may otherwise agree (the "**Closing**").

e. **Conditions to Closing.** Customary closing condition for a transaction consummated through sections 363 and 365 of the Bankruptcy Code. There is no financing condition.

8. The Auction will be conducted in the offices of Haynes and Boone, 901 Main St., Suite 3100, Dallas, Texas 75202, commencing at 10:30 a.m., on December 7, 2004. The court has set a hearing for 10:30 a.m., on December 8, 2004, in its regular courtroom in San Antonio, Texas to consider whether to approve the sale of the Sale Assets to the highest and best bidder at the Auction.

9. Based upon preliminary indications from interested parties, it is not anticipated that the Auction will generate sufficient value for the Sale Assets to pay all creditors claims against the Debtors. Accordingly, it is probable there will be no funds available for distribution to shareholders in these Chapter 11 cases.

RESPECTFULLY SUBMITTED this 24th day of November, 2004.

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ATTORNEYS FOR DEBTORS

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing Notice was served on the Master Service List and the List of Equity Security Holders and Creditors via first class United States Mail, postage prepaid, on or before the 26th day of November, 2004.

/s/ Eric B. Terry