Shareholder Activism Industry Report: *Restaurants*

Waheed Hassan, CFA
Senior Managing Director
whassan@allianceadvisorsllc.com

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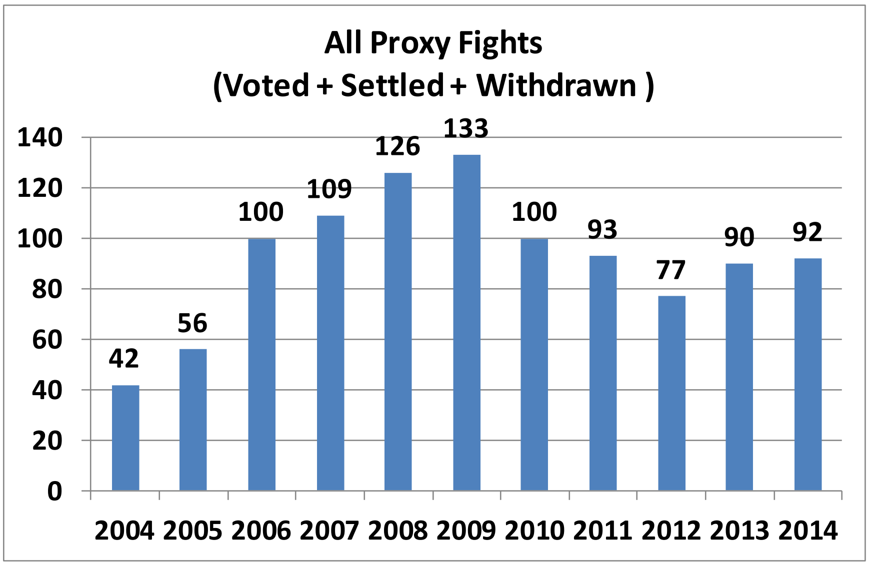
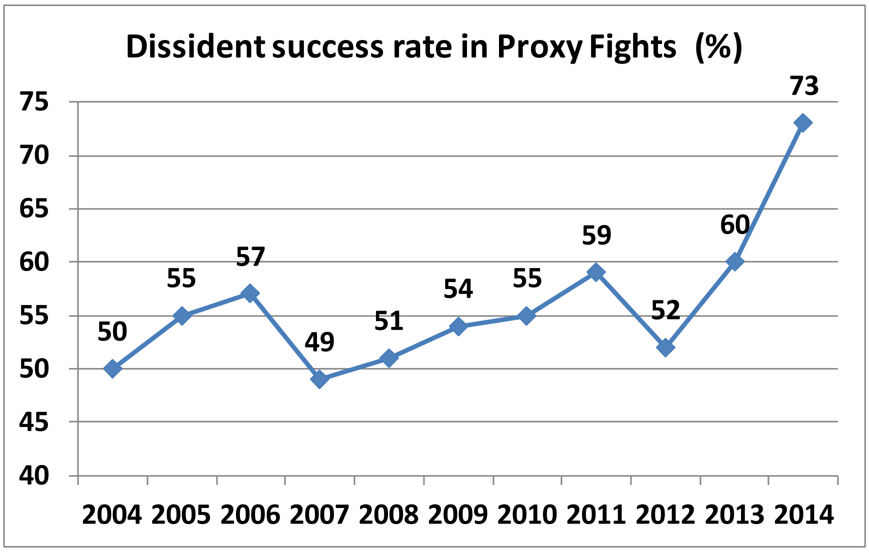
Executive Summary

The last couple of years have seen tremendous growth in shareholder activism. After peaking in 2009, the number of activist campaigns declined for the next three years, reaching a multi-year low of 77 in 2012. Last year, there were 92 campaigns, of which 32 went to a shareholder vote. More importantly, activist investors prevailed in 73% of the activist situations last year – the highest success rate in over a decade.

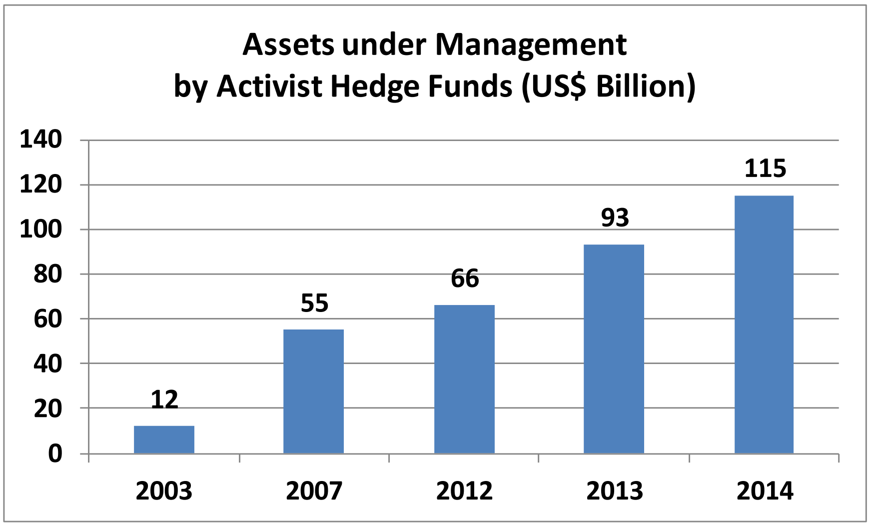


Source: FactSet

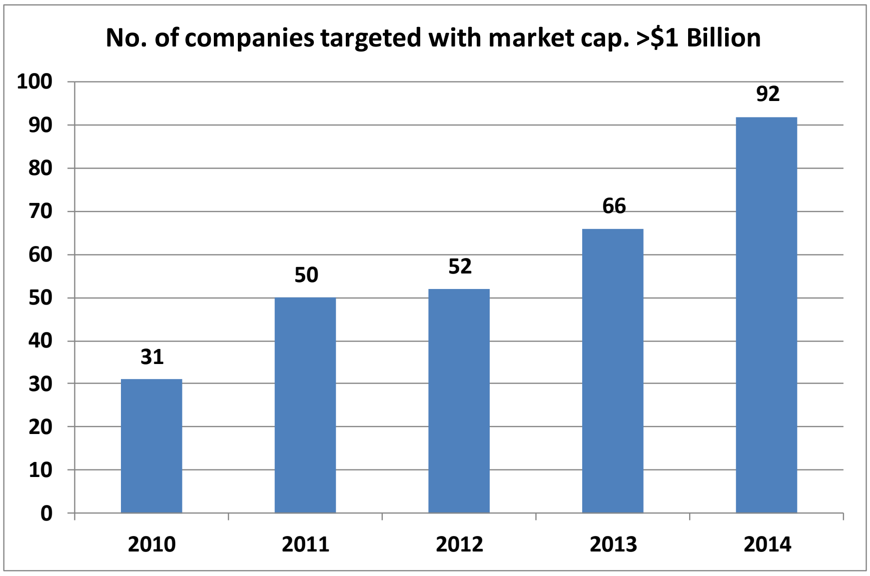


Source: FactSet

Not surprisingly, activist investing is now an accepted investment class. The inflow of capital coupled with greater acceptance of activist strategy – possibly due to their relatively strong track record – has not only emboldened these investors to target bigger companies but also resulted in emergence of several new 'activist funds.' In essence, market cap and sector are no longer an effective defense mechanism.



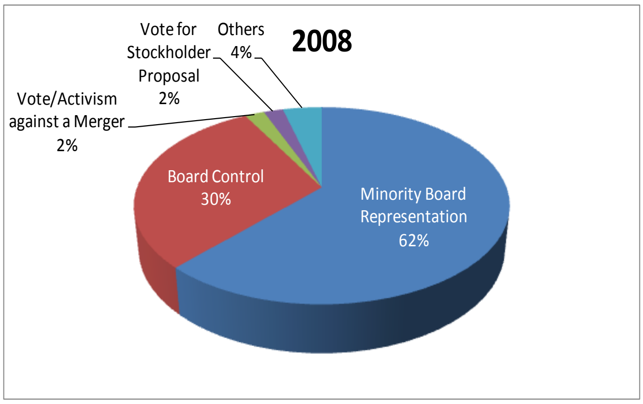
Source: Hedge Fund Research Inc. and The Wall Street Journal

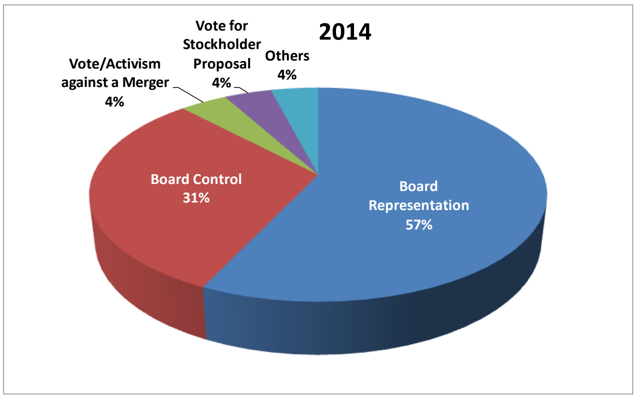


Source: FactSet

Activist Funds	PM's prior affiliation	Recent campaigns
Corvex Management	Icahn Enterprises	Commonwealth REIT, American Realty Corp.
Engaged Capital	Relational Investors	Oplink Communications, Abercombie & Fitch, Rentech, AeroVironment, Volcano Corporation
Privet Fund Management	SAC Capital	PFSweb, J. Alexanders, StarTek, RELM Wireless, Material Sciences Corp., Aware Inc.
Lone Star Value Management	Soros Fund Management	Rentech, Callon Petreoleum, Hudson Global, Miller Energy, Pantry Inc., Aetrium Incorp., SWS Group
Legion Partners *(received $200mn capital from CalSTRS in Jan. 2014)*	Shamrock	RCM Technologies, Perry Ellis International

While the number of activist campaigns and the size of targeted companies have been on the rise, it is important to note that the types of activist campaigns used have not changed much over the years. The majority of activist campaigns continue to be for minority board representation – primarily because institutional investors and proxy advisory firms (ISS and Glass Lewis) have a much lower hurdle for supporting minority slate than majority.





Source: FactSet

Overview of Activism in Restaurant Industry

The overall activism trend has been prominent in the restaurant space as soft consumer spending coupled with promotions/discounts has weighed heavily on restaurant profitability. Since 2010, several name-brand restaurants have been targeted for either board representation or pressure to maximize shareholder value (see table below).

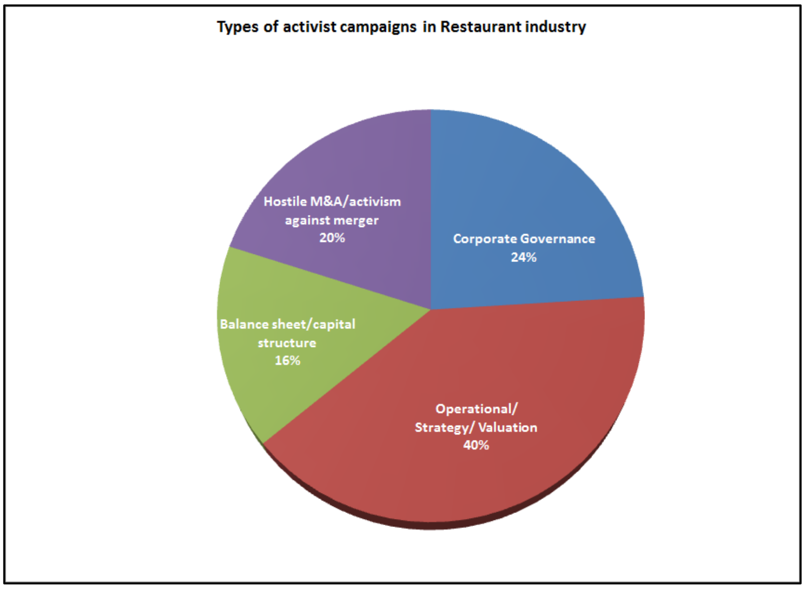
Company	Activist
Benihana Inc.	Coliseum Capital Management, LLC, Benihana of Tokyo
Biglari Holdings Inc.	Groveland Capital, LLC
BJ's Restaurants, Inc.	Clinton Group, Inc., Luxor Capital and PW Partners
Bob Evans Farms, Inc.	Sandell Asset Management Corp.
Bravo Brio Restaurant Group, Inc.	Red Mountain Capital Partners LLC
California Pizza Kitchen, Inc.	Clinton Group, Inc.
Caribou Coffee Company, Inc.	Accretive Capital Partners LLC
CKE Restaurants, Inc.	Porter Orlin LLC
Cosi, Inc.	BLUM Growth Fund, LLC (Brad Blum), Royce & Associates, Attiva Capital Partners, Lloyd Miller
Cracker Barrel Old Country Store, Inc.	Biglari Holdings Inc., Biglari Capital
Darden Restaurants, Inc.	Barington Capital Group, L.P., Starboard Value
Denny's Corporation	Oak Street Capital Management LLC & Dash Acquisitions, LLC
DineEquity, Inc.	Marcato Capital Management LLC, Scout Capital Management
Famous Dave's of America	Blue Clay Capital Management, LLC, Farnam Street Partners, PW Partners
J. Alexander's Corporation	Privet Fund Management LLC
Jamba, Inc.	Engaged Capital LLC, JCP Investment Partnership
Kona Grill, Inc.	Marcus E. Jundt (former CEO and chairman), Mill Road Capital
McCormick & Schmick's Seafood Restaurants, Inc.	Tilman J. Fertitta
Mexican Restaurants Inc.	Cross River Capital Management LLC
O'Charley's Inc.	Wellcap Partners LP
Popeyes Louisiana Kitchen, Inc.	Red Mountain Capital Partners LLC
Red Robin Gourmet Burgers, Inc.	Oak Street Capital Management LLC, Kovitz Investment Group LLC, Clinton Group, Spotlight Advisors
Ruby Tuesday, Inc.	Becker Drapkin Management LP and Carlson Capital LP

Source: FactSet

More importantly, activists have been quite successful in attaining their desired outcome – e.g. board representation or change in management. Activists gained board representation (either through a shareholder vote or settlement) at Benihana Inc., BJ's Restaurants, Bob Evans, Darden Restaurants, Famous Dave's, Jamba Inc., Red Robin Gourmet Burgers, and Ruby Tuesday.

Although the activists lost the proxy contest at Denny's Corporation, the company announced a new CEO within a month of the shareholder vote. Similarly, at Cosi Inc., activist pressure led to the resignation of the Chairman and interim CEO. In Dec. 2014, four months after the election of Sandell Asset Management's nominees to the board, Bob Evans announced that its CEO was stepping down.

In addition to seeking board representation and/or management changes, the restaurant industry has seen its fair share of shareholder opposition to merger announcements. Since 2010, shareholders have opposed M&A transactions at California Pizza Kitchen, Caribou Coffee, CKE Restaurants, and J. Alexander's Corp. At CKE Restaurants, shareholder pressure resulted in a 13.5% increase in the offer price, whereas at J. Alexander's the acquirer raised its offer by approximately 21%.



Source: FactSet

The proxy contest at Darden Restaurants ("Darden")

Last year's proxy contest at Darden was unique in several respects. While it started as a simple campaign by Barington Capital to create value through operational changes and business restructuring, it soon morphed into a complex situation with long-term implications for the board and management team.

A critical issue at Darden was its board's decision to sell Red Lobster to Golden Gate Capital without shareholder approval. Though it is fairly common for companies to so, it appears that shareholders are exerting greater influence on strategic board level decisions involving the sale/divestiture of significant business segments. In 2012, Relational Investors in collaboration with CalSTRS forced The Timken Company to spin off its steel segment through a non-binding shareholder proposal. Similarly, last year Carl Icahn successfully agitated at eBay to separate the PayPal segment.

In hindsight, it seems that Darden underestimated the reaction of proxy advisory firms and other institutional investors to the Red Lobster sale. Here, it is important to note that had it not been for Darden's shareholder-friendly corporate governance profile – i.e. it allowed shareholders to act by written consent and to call special shareholder meetings – Starboard Value would not have been able to provide an alternative platform for shareholders to voice their opinion on the Red Lobster transaction. The big governance failure was Darden's refusal to call a special meeting for the Red Lobster transaction after Starboard Value successfully submitted consents representing more than 50% of shareholders requesting the same.

While on the one hand Darden's board ignored shareholders desire to opine on the Red Lobster deal, on the other hand it seems to have succumbed to shareholder pressure by announcing a CEO change and replacing the majority of the legacy directors prior to the shareholder meeting. Interestingly, the CEO and board changes were announced less than one year after the company announced major strategic initiatives to create shareholder value. Despite new strategic announcements and wholesale board changes, Darden's shareholders voted in all twelve of Starboard Value nominees. This, we believe, sends a very strong message: making last-minute changes, especially in the midst of a proxy battle, is not an effective defense strategy.

In summary, there are several key takeaways from the Darden contest:

- For companies that do grant shareholders the right to act by written consent or call a special meeting, these rights should be taken seriously.
- Sale of business segments are still the prerogative of the management/board. That said, the sale of a business division at questionable valuation could expose the board to shareholder criticism.
- Strategic plans need to translate into shareholder value creation, otherwise they lose credibility.
- Changes to management and/or the board during a proxy contest are deemed reactionary and are unlikely to provide an effective defense.

Darden Restaurants, Inc. (DRI)

Activism type: *Operational*
Representation sought: *Majority slate (12 out of 12 seats sought)*
Outcome: *Activist Win*

Key Players

- Barington Capital Group (2.8% stake)
- Starboard Value LLP (5.6% stake)

Activist Arguments

- Significant share price underperformance compared to peers.
- History of poor acquisitions and capital expenditure (CapEx). Lagging return on capital.
- Poor operating metrics – declining same store sales, and high SG&A expense.
- Lack of market response to strategic initiatives as reflected in sustained decline in share price.
- Disregard for shareholder rights – failure to hold special meeting for Red Lobster sale despite more than 50% of shareholders submitting consents to do so.
- Failure to establish appropriate management incentives.
- Lack of confidence in incumbent board to lead the company.

Company Response

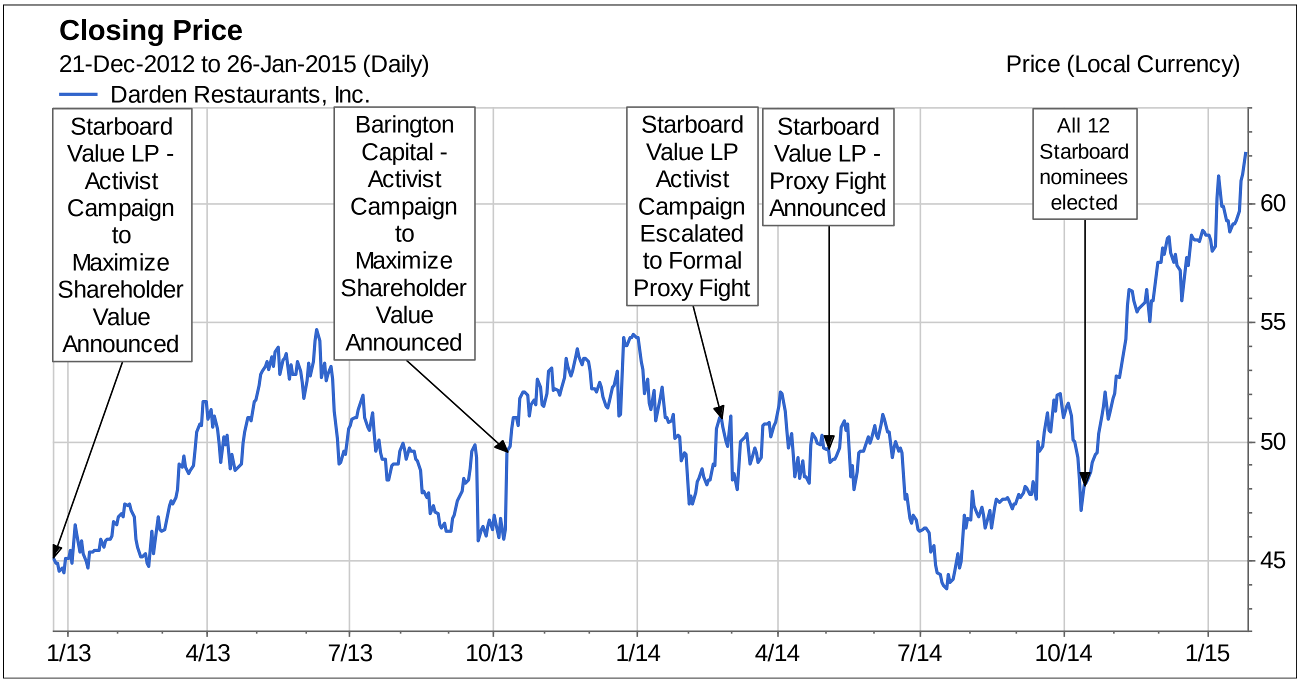
- Announced a comprehensive plan to enhance shareholder value by reducing CapEx, increasing cost savings, realigning management compensation, and increasing return on capital.
- Initiated a $500 million accelerated share buyback program.
- Began a new CEO search process.
- Made wholesale changes to the board by inducting four new board members and vacating four seats for the activist nominees – management slate had 8 candidates for the 12 member board.

Proxy Advisory Firm Recommendations

- ISS and Glass Lewis recommended FOR all 12 Starboard nominees.

Outcome

- All 12 Starboard nominees elected.



BJ's Restaurants, Inc. (BJRI)

Activism type: *Not disclosed*
Representation sought: *Majority slate (5 out of 10 seats sought)*
Outcome: *Settlement*

Key Players

- Luxor Capital Group LP, PW Partners Atlas Fund II LP, Zelman Partners LLC (16% combined stake)
- Clinton Group Inc. (0.5% stake)
- Both activist groups separately sought 5 board seats on a 10-member board.

Activist Arguments

- No detailed arguments presented.

Company Response

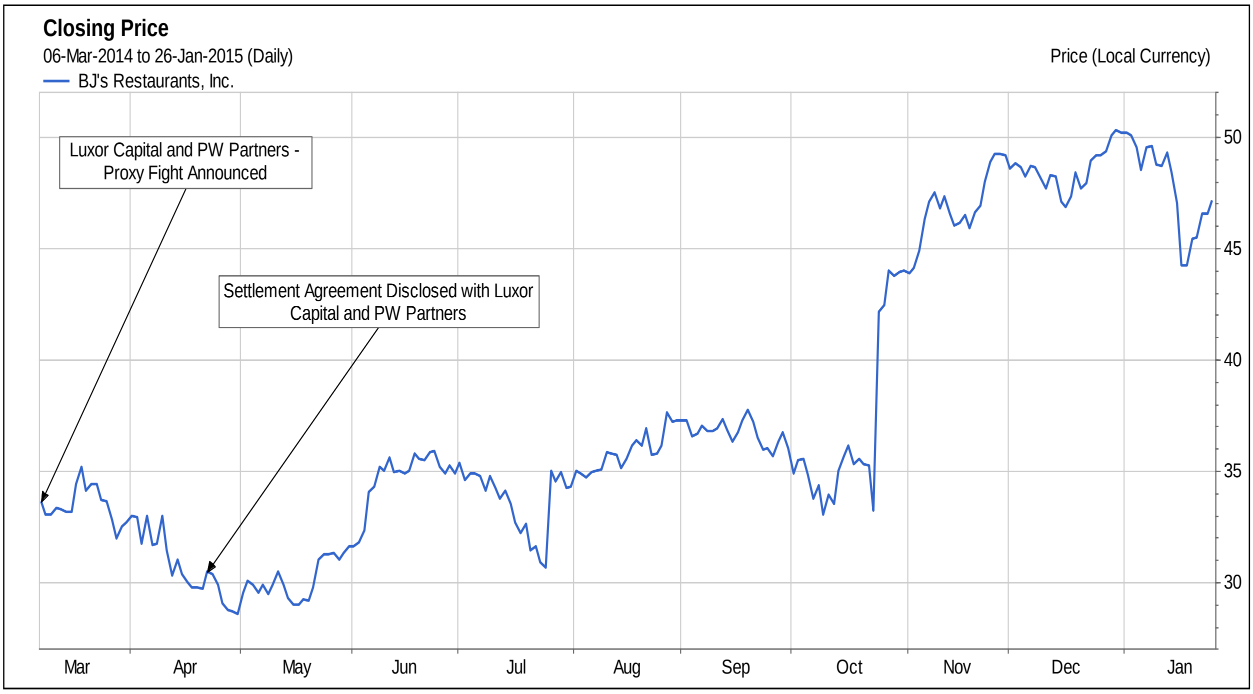
- "The Board remains highly focused on creating the optimal conditions to generate long-term value and will continue to take actions that support the interests of all shareholders."
- Announced $50 million share repurchase program.
- Clinton withdrew and did not nominate any candidates for election.

Proxy Advisory Firm Recommendations

- Not applicable as the fight was settled prior to proxy advisory firm recommendations.

Outcome

- Company settled. Luxor and PW Partners granted 3 seats and board size increased from 10 to 11.



Cracker Barrel Old Country Store, Inc. (CBRL)

Activism type: ***Operational***
Representation sought: ***Minority slate 2013 (2 out of 9 seats sought)*** **Outcome:** ***Management Win***

Key Players

- Biglari Holdings Inc./Biglari Capital (stake: 9.9% in 2011, 17.3% in 2012, and 19.8% in 2013). The investor ran three campaigns for board representation at Cracker Barrel.

Activist Arguments

2011- 2014

- Failure to maximize shareholder value as a result of poor management, flawed expansion strategy, low expectations, and deficient accountability.
- Board's lack of meaningful stock ownership.
- Declining unit-level customer traffic for the past seven consecutive years.
- Lack of financial transparency.
- Failure to close productivity gap in operating income per store.
- Poor capital allocation decision in opening new stores.
- Oppose company's shareholder rights plan.
- Company should pay $20/share special dividend (2013).
- Submitted non-binding proposal to pursue sale of the company (2014).

Company Response

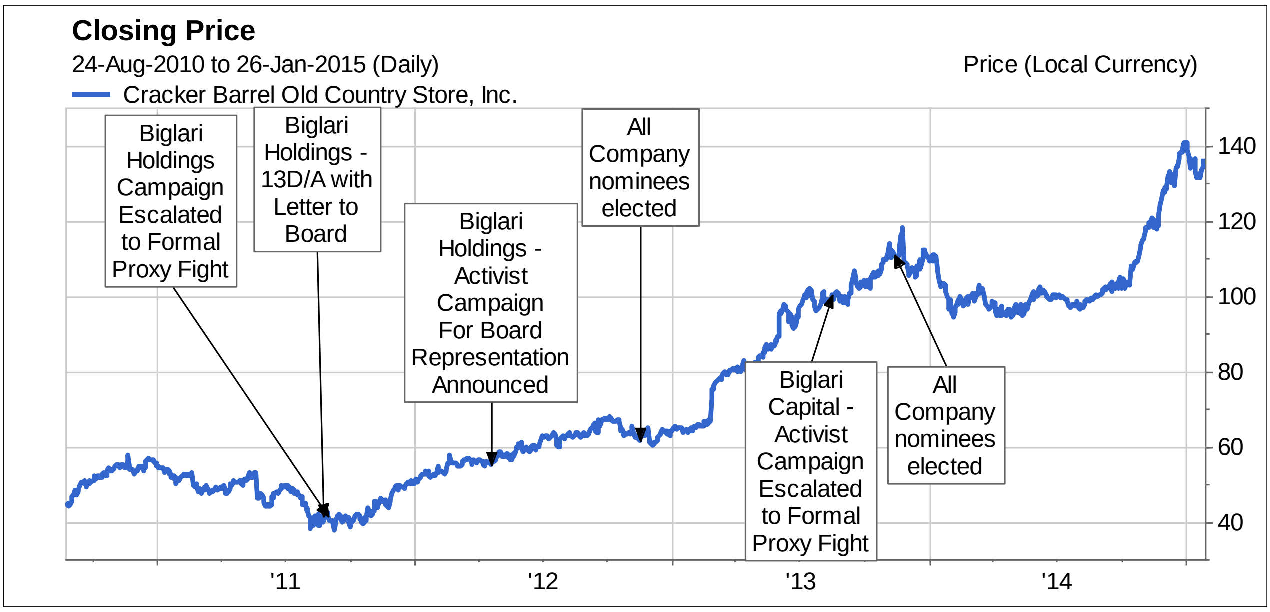
2011: Company hired a new CEO, announced an internal restructuring plan, nominated three new board members, raised cash dividend and announced a new $65 million share repurchase plan.
2012: Company focused on share price and operating metrics outperformance.

Proxy Advisory Firm Recommendations

- ISS and Glass Lewis voted FOR all management nominees in the 2011, 2012, and 2013 campaigns.
- ISS recommended AGAINST the adoption of a poison pill in 2011.
- ISS recommended AGAINT a shareholder proposal for a $20/share special dividend in 2013.
- ISS recommended AGAINST a shareholder proposal to sell the company in 2014.

Outcome

- Company nominees elected in 2011-2013 contests. Shareholder proposals to pay $20/share special dividend and to sell the company defeated.



Bob Evans Farms Inc. (BOBE)

Activism type: ***Operational/Balance Sheet***
Representation sought: ***Majority slate***
(8 out of 12 seats sought) **Outcome:** ***Split Win***

Key Players

- Sandell Asset Management Corp. (8.8% stake)

Activist Arguments

- Sell or spin off food products business, unlock real estate value through a sale-leaseback transaction, and implement a large self-tender with the proceeds generated from the first two actions.
- Suggested that the company could be worth $73 to $84 per share.

Company Response

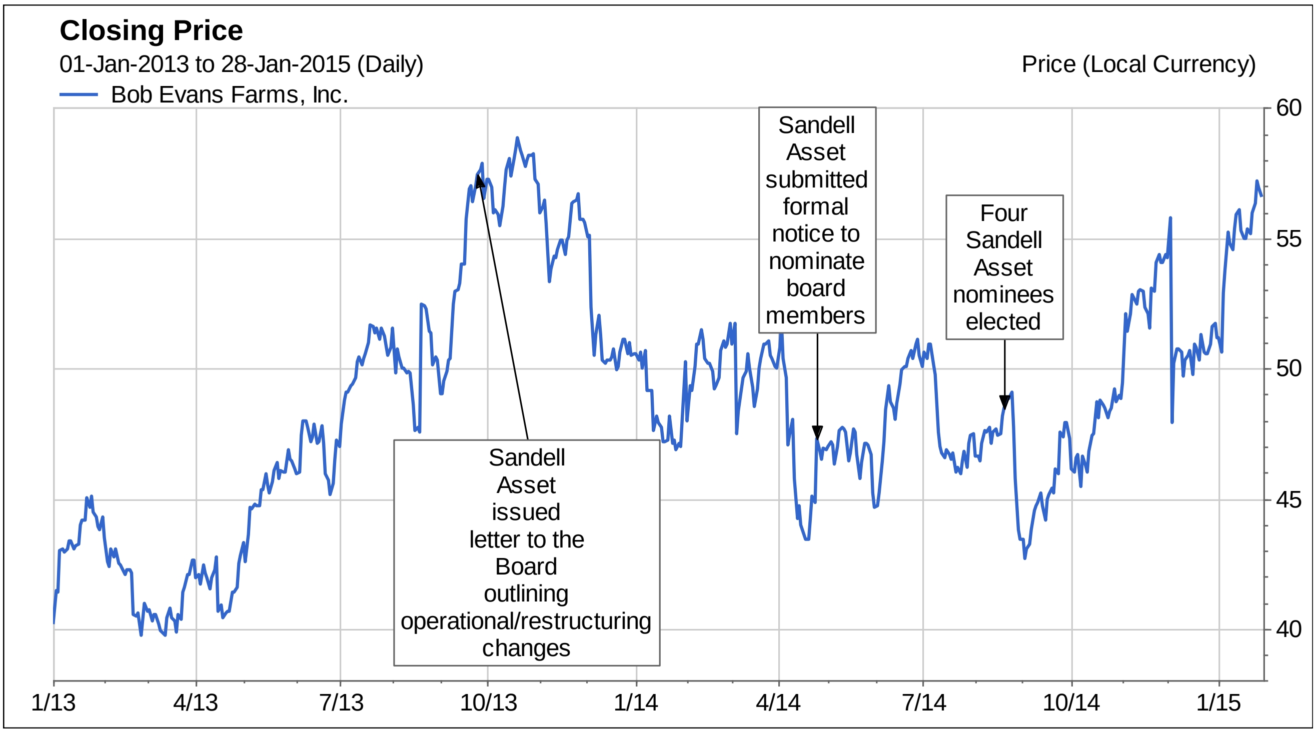
- Execute a growth strategy built on a recently completed two-year transformational investment program.
- Build on its track record of returning capital to stockholders.
- Consider other strategic opportunities to benefit stockholders.
- Company nominated 10 candidates for the 12 member board.

Proxy Advisory Firm Recommendations

- ISS recommended FOR four Sandell Asset nominees.
- Glass Lewis recommended FOR six Sandell Asset nominees.

Outcome

- Four Sandell Asset nominees elected.



Famous Dave's of America (DAVE) **Activism type:** ***Not disclosed***
Representation sought: ***Minority slate (1 out of 6 seats sought)*** **Outcome:** ***Settlement***

Key Players

- PW Partners Capital Management LLC (9.9% stake)

Activist Arguments

- Details not disclosed.

Company Response

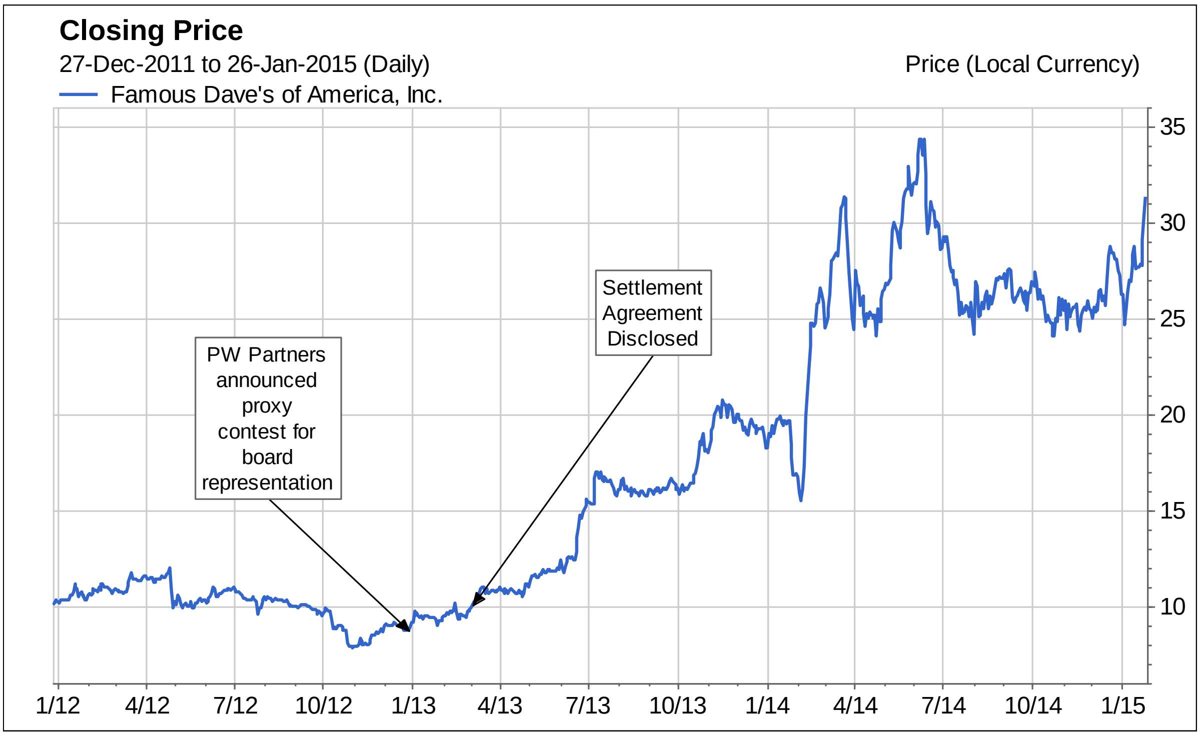
- Company settled with PW Partners and nominated Walsh to the board, provided that PW Partners withdrew their nomination and agreed to standstill provision lasting 10 days prior to deadline to submit director nominations.

Proxy Advisory Firm Recommendations

- Not applicable as the fight was settled prior to proxy advisory firm recommendations.

Outcome

- Company settled and added PW Partners' nominee to the board.



J. Alexander's Corporation (JAX)

Activism type: *Operational*
Representation sought: *Majority slate*
(4 out of 4 seats sought)* Outcome: *Withdrawn

Activists

- Privet Fund Management LLC (10.1% stake)

Activist Argument

- Company needed to improve operational and financial performance.
- Upon merger announcement, Privet opposed the deal and urged the company to re-open merger discussions with all parties in order to secure the highest price for shareholders. Privet said that it appeared that the deal was not a product of any "robust auction with competitive bidding."
- Following the merger announcement, Privet submitted notice of its intent to call a special meeting to add two board members.

Company Response

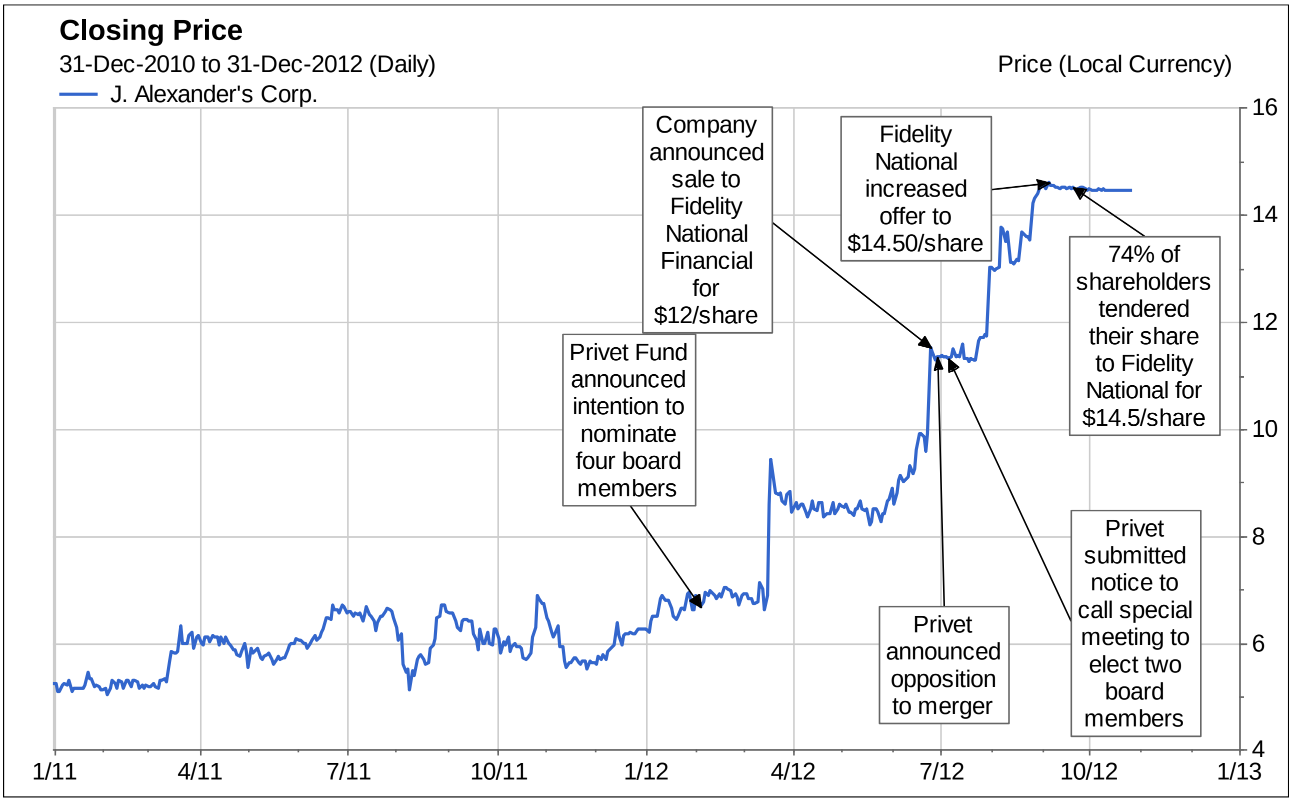
- Company announced an agreement to be acquired by a subsidiary of Fidelity National Financial, Inc. for $12/share in cash or a combination of cash and stock.
- Following opposition by Privet and receipt of higher competing bids, Fidelity National agreed to increase its consideration from $12/share to $13/share and finally to $14.50/share in cash.

Proxy Advisory Firm Recommendations

- No advisory firm recommendations were issued.

Outcome

- 74% of shareholders tendered their shares prior to the annual meeting.



Benihana Inc. (BNHNA)

Activism type: ***Corp. Governance***
Representation sought: ***Minority slate***
2012 (3 out of 9 seats sought) **Outcome:** ***Withdrawn***

Key Players

- Benihana of Tokyo, Inc. ("BOT", stakes: 38.1% in 2010, 31% in 2012). The investor ran campaigns in 2010 (proxy fight for 1 board seat), 2011 (proxy fight to oppose reclassification of shares) and 2012 (proxy fight for 3 board seats).
- Coliseum Capital Management (14.9% stake) – sought 1 seat in 2010.

Activist Arguments

- 2010: Board lacked significant number of independent directors and had questionable track record of holding management accountable.
- 2011: BOT announced its opposition to the company's proposed reclassification of Class A common stock into common stock, to be voted on at an upcoming special meeting. BOT said that such a reclassification would be dilutive to common stockholders.

Company Response

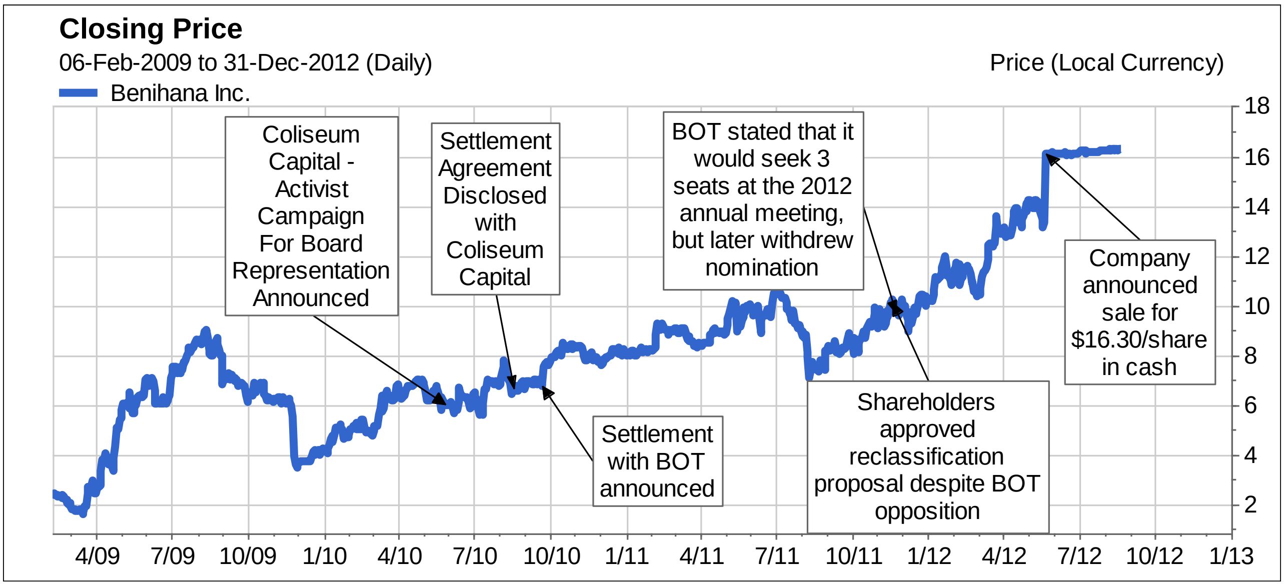
- Proven ability to execute operationally and deliver strong performance results for its stockholders.
- Strong sales momentum, included twenty-three consecutive periods of comparable sales growth as of December 8, 2011.
- Approval of the reclassification proposal in 2011 represented a transformational event for Benihana – one that simplified the Company's capital structure instantly by creating a single class of Benihana's Common Stock.

Proxy Advisory Firm Recommendations

- 2011: ISS recommended that shareholders reject the reclassification proposal.
- 2012: No advisory firm recommendations were issued for the proxy contest.

Outcome:

- 2010: Company settled: Granted 1 seat each to BOT and Coliseum Capital.
- 2011: Company's reclassification proposal passed.
- 2012: BOT withdrew its request seeking three board seats. All management nominees elected.



Ruby Tuesday (RT)

Activism type: *Not disclosed*
Representation sought: *Minority slate (3 out of 8 seats sought)* **Outcome: *Settlement***

Key Players

- Becker Drapkin Management LP (1.4% stake)
- Carlson Capital LP (5.5% stake)

Activist Arguments

- No detailed arguments presented.

Company Response

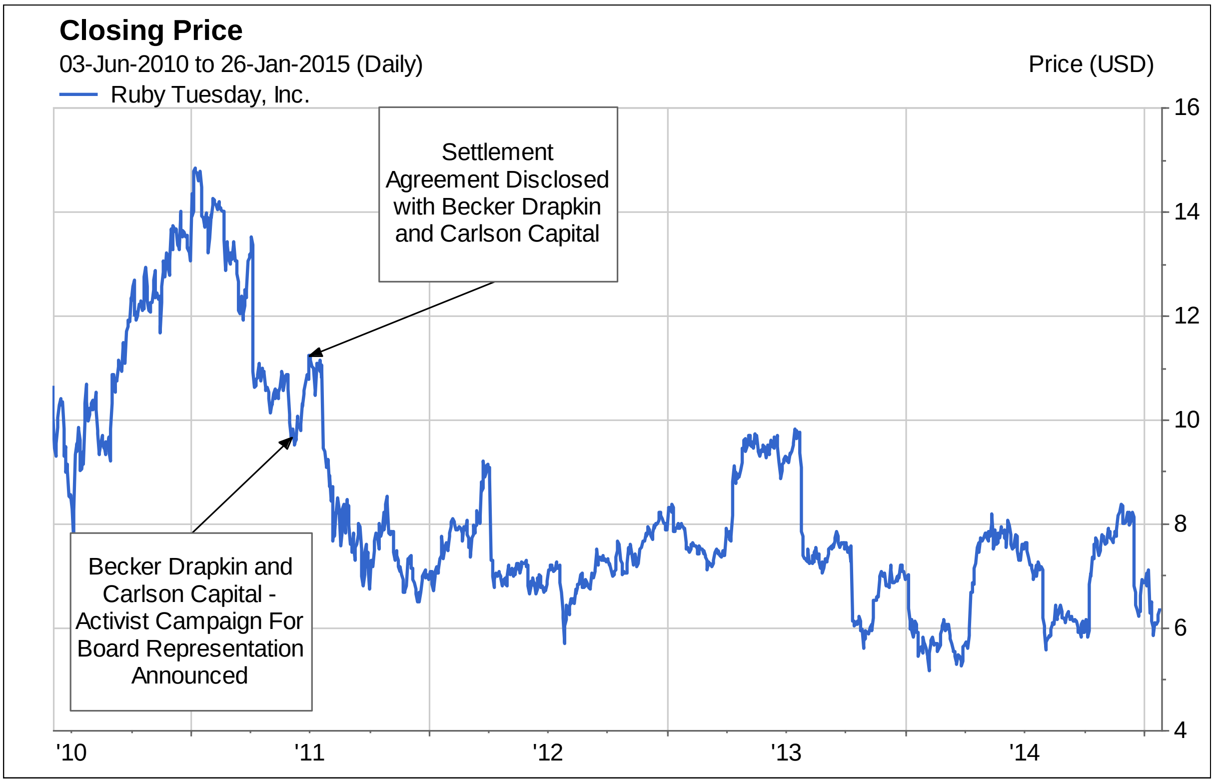
- "The Board of Directors and management team are committed to maximizing the long-term value of our Company for the benefit of all of our shareholders and are always open to hearing the views and opinions of shareholders as to how the Board and management can continue to create such value."

Proxy Advisory Firm Recommendations

- No advisory firm recommendations were issued.

Outcome

- Company settled and added two activist nominees to the board. The board size was increased by one to accommodate the activist nominee.



McCormick & Schmick's Seafood Restaurants Inc. (MSSR)

Activism type: *M&A*
Representation sought: *Minority slate*
Outcome: *Acquisition by hostile bidder*

Key Players

- Tilman J. Fertitta (through Landry's Restaurants, Inc, 10.1% stake)

Background

- 4 April 2011 – Landry's Restaurants, Inc. announced its intent to commence a cash tender offer for McCormick & Schmick's Seafood Restaurants, Inc. at $9.25 per share. Landry's had been taken private by its CEO Tilman J. Fertitta, who directly owned 10.1% of McCormick shares.
- 7th April 2011 – Fertitta filed a tender offer statement commencing the offer. Since McCormick had not responded to Fertitta's offer, a week later Fertitta filed a preliminary contested proxy statement announcing a proxy fight to withhold votes at the upcoming annual meeting. Fertitta was of the view that as the deadline to nominate director candidates had passed, withholding votes at the meeting would help prevent a quorum and thereby prevent the company from conducting business at the annual meeting.

Company Response

- Company rejected Fertitta's initial tender offer and announced a review of strategic alternatives including sale of the company.
- Adopted a one-year poison pill (shareholder rights plan) with a 15% trigger.

Proxy Advisory Firm Recommendations

- No advisory firm recommendations were issued.

Outcome

- On Nov. 8, 2011, Company agreed to be acquired by Landry's for $8.75 per share.

Red Robin Gourmet Burgers, Inc. (RRGB)

Activism type: *Operational and Corp. Gov.*
Representation sought: *Minority slate (2 out of 10 seats sought)*
Outcome: *Settlement*

Key Players

- Oak Street Capital Management LLC (9.0% stake)
- Kovitz Investment Group LLC (4.5% stake)

Activist Arguments

- Remove the poison pill, declassify the board, reduce corporate overhead, implement a temporary moratorium on new unit expansion until sales and profitability are restored at existing locations.
- Redirect operating cash flow towards a $50 million share repurchase program.

Company Response

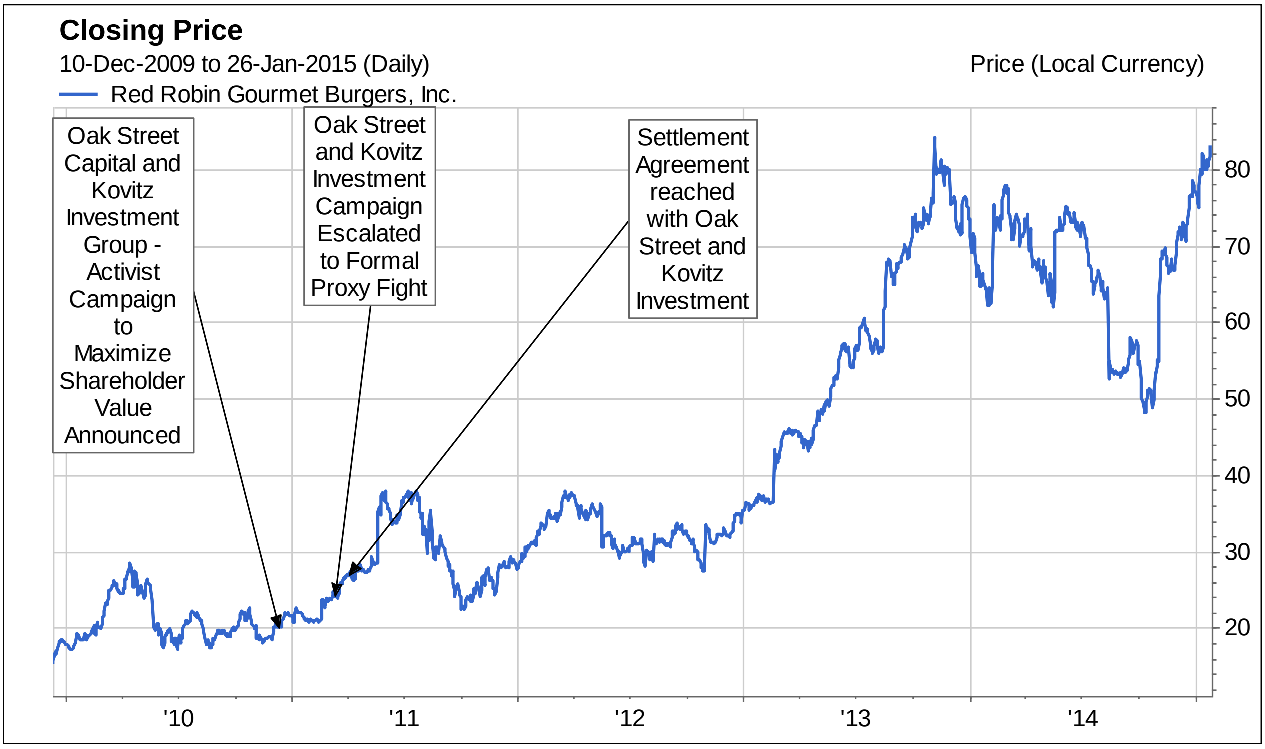
- Company amended provisions of the poison pill making it more shareholder-friendly.

Proxy Advisory Firm Recommendations

- No advisory firm recommendations were issued.

Outcome

- Company settled by expanding the board by one and appointing two Oak Street nominees to it.



Denny's Corporation (DENN)

Activism type: *Operational*
Representation sought: *Minority slate (3 out of 8 seats sought)*
Outcome: *Management Win*

Key Players

The Committee to Enhance Denny's was comprised of several hedge funds including:

- Soundpost Partners LP (2.3% stake), Oak Street Capital Management LLC (2.0% stake)
- Dash Acquisitions LLC (Dash, 1.2%), Murano Partners LP (Murano, 0.8%)
- Lyrical Asset Management LP

Activist Arguments

- Poor share price performance.
- Company's failure to grow system-wide restaurants and loss of market share to IHOP.
- Declining operating trends such as guest traffic.
- Inappropriately high general and administrative expenses.
- Expensive and ineffective marketing strategies.
- Imprudent capital allocation decisions.
- Lack of accountability for management at the board level.
- Marginalization of shareholders and franchisees.

Company Response

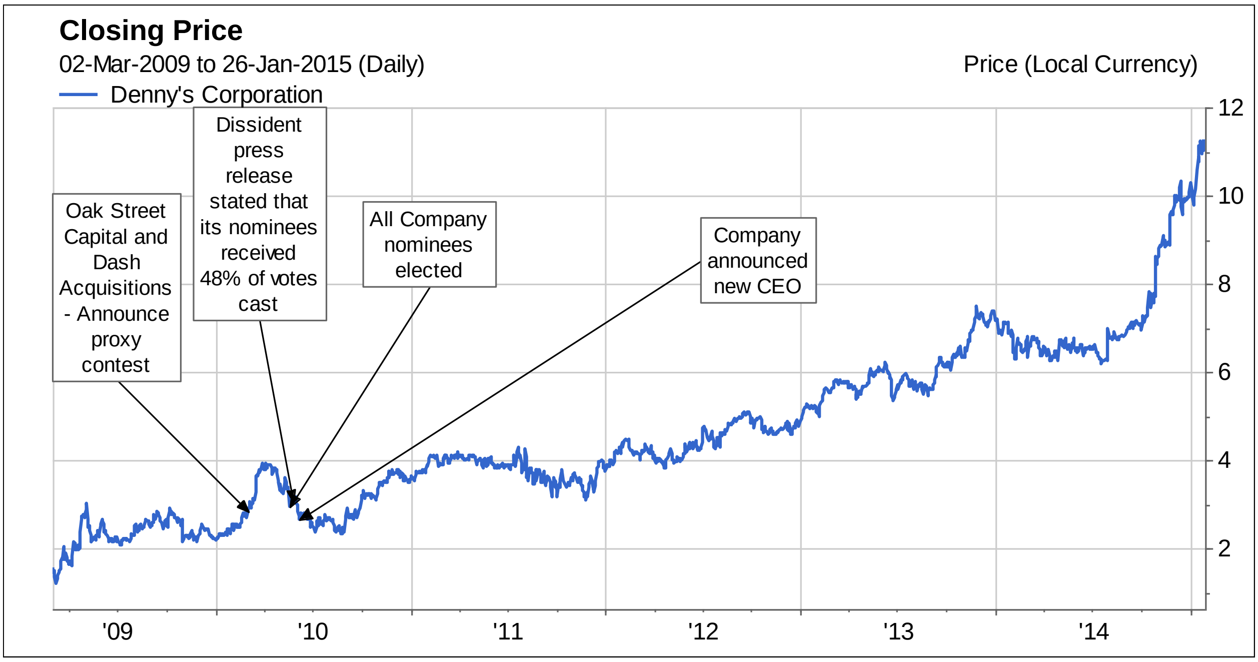
- Company has a clear strategic plan which the management is aggressively implementing.
- In the past three years, the company has significantly grown its restaurant openings, profitability, free cash flow, and return on assets. During the same time it has significantly reduced its debt, debt leverage ratios, operational and G&A expenses and capital expenditures.

Proxy Advisory Firm Recommendation

- ISS recommended FOR one activist nominee.
- Glass Lewis recommended FOR all management nominees.

Outcome

- All management nominees elected.



Kona Grill, Inc. (KONA)

Activism type: ***M&A related proxy contest***
Representation sought: ***Minority slate (3 out of 7 seats sought)***
Outcome: ***Withdrawn***

Key Players

- Mill Road Capital (9.8% stake) – nominated 3 candidates
- Marcus E. Jundt (former CEO and chairman, 6.7% stake) – nominated himself

Activist Arguments

- Company suffers from poor governance with consistent pattern of self-dealing.
- Stock price and operational performance lags behind peers.
- Board lacks necessary experience to allow management team to succeed.

Company Response

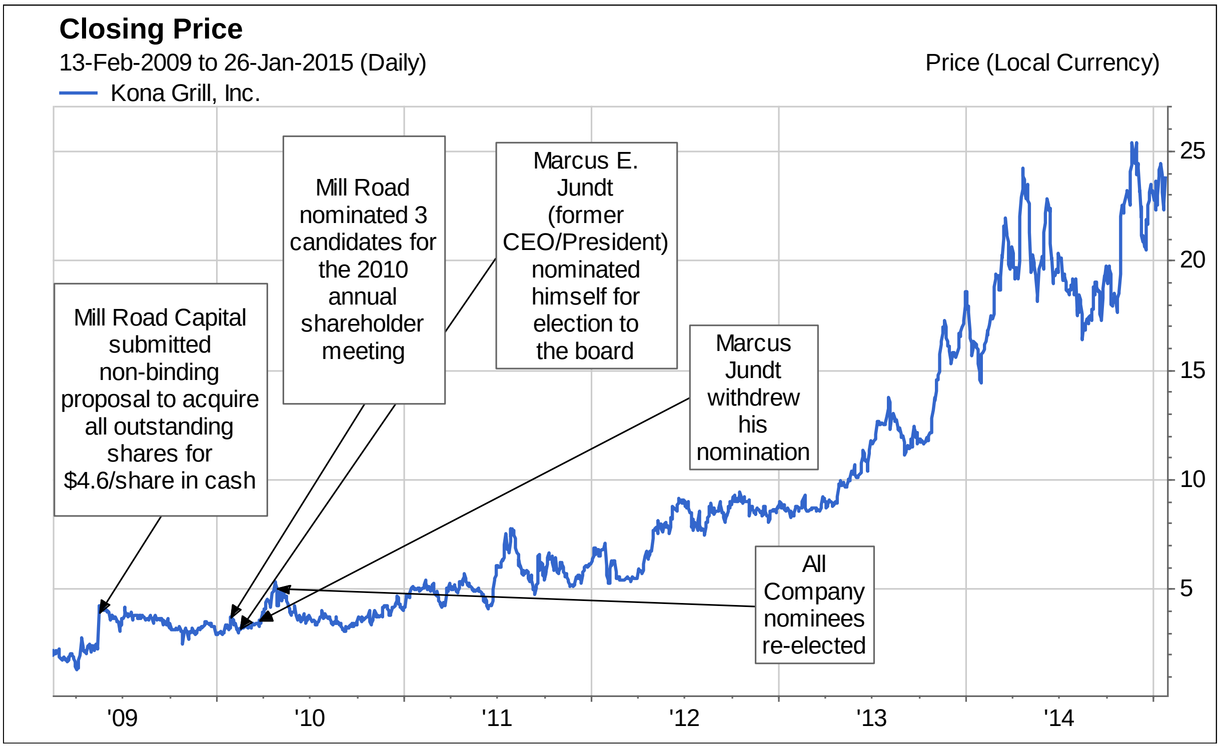
- Economic downturn had impacted consumer spending.
- Proactively hired a new CEO and inducted a new management team with extensive restaurant experience.
- Significantly reduced costs relating to salary and benefits, travel and consulting services
- Terminated stockholder rights plan in response to shareholder vote at the 2009 Annual Meeting

Proxy Advisory Firm Recommendations

- ISS recommended FOR one Mill Road nominee.
- Glass Lewis recommended FOR all management nominees.

Outcome

- All management nominees elected.
- Marcus Jundt withdrew his self-nomination and no action was taken.



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