Turnaround Pieces in Place

A case study of Ruby Tuesday (RT)

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Safe Harbor

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Cove Street Capital

- SEC-registered firm founded in 2011 by value investing veteran Jeff Bronchick
- Concentrated, small cap value focus
  - Business, Value, People
- Small team of analysts
  - Jeff Bronchick, Eugene Robin
  - Ben Claremon
    - Formerly known as The Inoculated Investor
- http://www.covestreetcapital.com

Investment Philosophy

- Classic fundamental, research-driven value investing
- Concentrate on best ideas
    - 30-35 stock portfolio
- Think and act long-term
    - Mathematics of compounding
    - Less is more

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4 Step Investment Process

- Idea generation
  - Screen for both good and cheap businesses
  - Management meetings
  - Collective investment experience
- Data download
  - CSC proprietary spreadsheet
  - Company quality
    - Buffett stock—great business at a reasonable price?
    - Graham stock—cheap security that provides a large enough margin of safety?

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4 Step Investment Process (cont.)

- Team tackle and deep dive
  - 2 long, 1 short
  - Triangulate intrinsic value
    - DCF, SOTP, multiples analysis, EPV
  - Sustainable competitive advantage?
  - PEST analysis—Political, economic, social, technological risks
- Portfolio consideration
  - Full (5%) or half (2.5%) position?

Ruby Tuesday: Background

- Company was founded in 1920 and is based in Maryville, Tennessee
- Ruby Tuesday concept
  - 790 stores in 45 states and 11 foreign countries (immaterial)
  - ~90% of system is company owned stores
- Other concepts
  - Lime Fresh—small; growth vehicle
  - Wok Hay, Truffles, Marlin & Rays—closing or selling to focus on Lime and Ruby Tuesday

RubyTuesday

- **Restaurant Count:** 790 restaurants (712 company - owned & 78 franchised) representing ~98% of total revenue
- **Cuisine:** American Classic
- **Format:** Casual Dining
- **Avg. Volume/Yr:** $1.75M
- **Avg. Net Check:** $12.50 - $13.00
- **Avg. Size:** 5,000 sq. ft.
- **Future Strategy:** "Cash cow" brand which is our main focus as a Management Team

Source: Company presentation

Ruby Tuesday: Market data & financials

- Stock price: $7.45
- Shares outstanding: 60.4mm
- Market cap: $449mm
- Enterprise value: $732mm
- Adjusted Debt/EBITDAR: 3.6x
- Number of unencumbered, owned stores: 290
- EV/TTM EBITDA: 7.5x
- Buyback authorization: 12.7mm shares (as of 1/9/13)
    - Represents 21% of basic shares outstanding

Five Year Stock Price Chart

Source: Yahoo Finance

Source: Capital IQ, CSC estimates

Ruby Tuesday: What Happened?

- Stock hit a high around $33 in March 2006
  - Stock has languished since post -2009 rebound
- Ruby concept has struggled to generate positive same store sales

	2006	2007	2008	2009	2010	2011	2012
$1 in SSS	$1	$0.99	$0.89	$0.82	$0.81	$0.82	$0.78

- Average unit volumes have fallen ($ millions)

2007	2008	2009	2010	2011	2012
$2.13	$1.92	$1.78	$1.79	$1.79	$1.80

- As a result, EBITDAR margins have plummeted

	2007	2008	2009	2010	2011	2012
EBITDAR Margin	19.7%	15.1%	14.6%	15.3%	14.0%	11.8%

- RT has had to close stores and buy underperforming stores from franchises

Historical Stock Chart

Sources: CSC estimates, Capital IQ, company filings

Ruby Tuesday: What Now?

- New CEO
- New CFO
- Activist shareholder involvement
- Shift of focus from coupons to TV advertising
    - Ads funded by $40M in cost savings
- Lime Fresh purchase
- Monetization of real estate assets

Ruby Tuesday: New Leadership

- Founder Sandy Beall retired as Chairman and CEO
    - Sandy was likely not the guy to turn around RT
- JJ Buettgen hired as CEO November 19th, 2012
    - Former Chief Marketing Officer of Darden Restaurants (DRI)
    - 20 years of experience in restaurant and consumer industries
    - Immediate impact:
        - Closed 29 Ruby Tuesday stores in Q2 2013
        - Closing 13 Marlin & Rays and 1 Wok Hay immediately
        - Selling 2 Truffles Grill stores
        - Closing 2 recently-opened Lime Fresh stores
        - Expect a $19-$22mm impairment (only $2-$5mm in cash charges)
    - 250K options cliff vest if the stock hits $14
- Michael Moore hired as CFO June 5th, 2012
    - Former CFO of Pamida Stores and Advanced Auto Parts (AAP)

Source: http://www.restaurantnews.com

Ruby Tuesday: Goals

- Opportunity: generate same store sales gains that improve store level operating margins and drive company operating leverage
- New management's goals:

- Annual revenue growth of 3% - 5%
- Positive same-restaurant sales driven primarily by traffic growth
- Annual EPS growth of 15% – 20% per year
- Adjusted EBITDA of $135M – $145M
- Free Cash Flow levels of $50M – $60M+
- Net Debt/Adjusted EBITDA ratio of <2.0X

Source: Company presentation

Ruby Tuesday: Margin Opportunity

- Use EBITDAR to make the numbers somewhat more comparable
  - Franchised versus company stores
  - Owned versus rented real estate
- Reason for huge margin drop at RT
  - Suffered a spike in payroll and restaurant operating costs between FY 2007 and FY 2008
    - RT has never recovered from that hit
  - Only 1 year of positive same store sales since then--.9% in FY 2011
- Benchmarking vs. companies w/ low levels of franchisees
  - Ruby Tuesday (RT)

	2007	2008	2009	2010	2011	2012
EBITDAR Margin	19.7%	15.1%	14.6%	15.3%	14.0%	11.8%

  - Darden (DRI)
    - 1900+ stores, no US/Canadian franchisees

	2007	2008	2009	2010	2011	2012
EBITDAR Margin	15.1%	14.4%	14.4%	15.1%	16.0%	15.5%

Sources: CSC estimates, Capital IQ and company filings

Margin Opportunity (cont.)

- Cracker Barrel Old Country Store (CBRL)
  - 600+ stores, no franchised stores

	2007	2008	2009	2010	2011	2012
EBITDAR Margin	11.9%	11.2%	11.2%	12.2%	12.2%	12.6%

- P.F. Chang's China Bistro (pre-buyout)
  - About 375 stores, minimal franchising

	2006	2007	2008	2009	2010	2011
EBITDAR Margin	14.9%	13.7%	14.1%	15.1%	15.3%	14.7%

- There is no perfect comp
  - But, comp data suggests that RT is under-earning relative to its peers
  - RT's current operating, EBITDA and EBITDAR margins are below its cost of capital

Sources: Capital IQ and company filings

Ruby Tuesday: Corporate Governance

- Activist shareholder involvement
  - Becker Drapkin Management
  - Controls about 4.8% of shares outstanding
  - Matt Drapkin is now the non-executive Chairman of the Board
  - Compensation package for new CEO shows the influence of Becker Drapkin
  - Exerting influence over capital allocation
    - Decision to monetize real estate assets
  - 12.7mm share buyback authorization
    - Purchase of 2.4M shares in Q2 2013
- Kevin Clayton from Berkshire Hathaway's Clayton Homes on the board as well

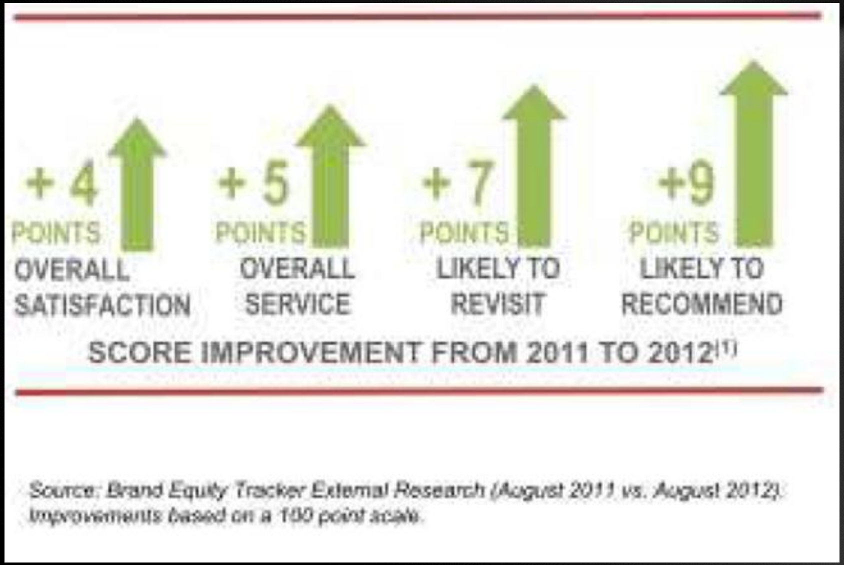
Ruby Tuesday: Advertising Strategy

- Shift from coupons to TV advertising
  - Spent $92M on coupons in FY 2011 and expect to only spend $55M on FY 2013
  - FY 2013 TV ad spending: $78-$82M versus $47.9M in FY 2012
  - Marketing is CEO Buettgen's specialty
- Why did RT move away from TV advertising?
  - 2009 Annual Report: "Our three largest bar-grill competitors spent a combined estimate of $325-350 million on television in calendar 2008, compared to our total of $23 million, creating such a disparity that our message was getting lost in a crowded advertising market."
- CEO Buettgen on coupons: Q2 2013 call
  - "My opinion is coupons are an integral mix or a part component of the mix. I would say that on the extreme, if we were 100% reliant upon coupons, that would be dangerous. On the other hand, to totally walk away from price incentives like coupons in such a competitive environment, in such a challenging consumer environment, would be a foolish decision. So one of the things that we continue to work on is what's the right balance between couponing and the other tools we have in our marketing arsenal."

Sources: Capital IQ and company filings

Ruby Tuesday: Telling the Story

- Disconnect between positive customer scores and traffic
  - Q1 2013 call:
    - "In our most recent quarter, approximately 74% of our guests rated their experience a 5 on a 1 to 5 scale, and 92% rated their experience a 4 or a 5"



Sources: Capital IQ and company presentation

Ruby Tuesday: Lime Fresh

- Purchased Lime Fresh on 4/4/12 for $24mm
- Mexican chain with restaurants in Florida & along the east coast
- Management believes Mexican food QSRs have positive secular growth trends
- Small now but provides a growth vehicle for the future
- Plan to open 10-12 stores in FY 2013 and 20+ thereafter
  - Will end FY 2013 w/ 22-25 stores
- Favorable EBITDA margins, ROICs and cash on cash returns
  - New store CAPEX: $750K

Targeted Financial Metrics[3]	
Revenue	$1.4 million[1]
Average Net Check	$9.25 - $9.75
EBITDA	$250 - $275k
EBITDA Margin	17% - 20%
Average Size	2,300 sq. ft.
Cash-on-Cash Return (pre-tax)	**35% - 40%**
ROIC	**12% - 14%**
FY13 Unit Growth[2]	12 - 16

Source: Company presentation

Ruby Tuesday: Real Estate Assets

Source: Company website

- State of the store base
  - Large remodel completed in FY 2008
  - $57mm spent in FY 2008
  - CEO does not anticipate big remodel spending
  - Maintenance CAPEX around $20mm
- Monetization opportunity
  - 290 owned, unencumbered stores
  - Recent average proceeds per sold store: $2.3mm
    - Implied real estate value of $560mm vs. $490mm market cap
    - Provides a margin of safety
    - Proceeds used to buy back shares
- Management is intent on executing sale-leasebacks
  - Looking to monetize 20 additional stores over the next 6 quarters

Ruby Tuesday: Valuation

- Triangulation of value
  - Intrinsic value depends heavily on margin assumptions
    - If RT can get back to FY 2010 EBITDAR margins (15.3%) => lots of upside
  - DCF analysis
    - Assumptions: 9.8% WACC, limited sales growth, 10% EBITDA Margins by FY 2016
    - Leads to a conservative price around $9.50
      - Assuming 12% EBITDA margins lead to price around $15
  - Multiples analysis
    - Assumptions: 15.7x P/E multiple (15% discount to comps), 10% EBITDA margins by FY 2016, reduced share count due to buybacks, discounted back at 9.8% WACC
    - Leads to a conservative price around $9.25
      - Assuming 12% EBITDA margins lead to price around $13
- NOL as of Q4 2012 of $158mm
- Real estate value provides downside protection

Ruby Tuesday: Short Thesis

- Spending on TV advertising will not be effective because RT will be meaningfully outspent by larger competitors
- Purchase of Lime and the focus on its growth is misplaced as Lime is not Chipotle and will always be too small to move the needle
- New CEO will soon realize the magnitude of the needed operational turnaround and will push margin improvement targets out a number of years
- Ruby Tuesday is an old, tired concept that does not have the ability to attract new, younger customers
- Achieving the former margins will be nearly impossible due to changes in franchise base and given that same store sales increases will be elusive in a strained consumer environment

Ruby Tuesday: Conclusion*

- There seems to be little downside with a number of positives:
  - Additional sale-leasebacks and share buybacks
  - New management team in place
  - Margins at never before seen, low levels
  - Lime Fresh opportunity
  - Stock looks to be discounting limited margin upside
  - What if something good happens?
    - "Downside appears to be boredom."
- Becker Drapkin watching capital allocation and spending

Source: www.greatpriceshere.com

**Please read in conjunction with the Safe Harbor statement located on Slide 2 of this presentation*