NEW BEST IDEA: LONG BOBE

HEDGEYE RESTAURANTS
May 8, 2014
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Bob Evans was founded in 1948, when the company’s namesake began making sausage on his farm in southeastern Ohio for family and friends.

The business was incorporated in Ohio in 1957 and became publicly traded in 1963.


Bob Evans Restaurants owns and operates 562 full-service restaurants in 19 states across the United States, primarily in the Midwest, mid-Atlantic, and Southeast.

BEF Foods produces and distributes a variety of refrigerated and frozen food items to more than 30,000+ retail locations across the United States and Mexico.
## BUSINESS SEGMENTS

### BOB EVANS FARMS (BOBE)

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Price</td>
<td>$47.01</td>
</tr>
<tr>
<td>52-Week High</td>
<td>$60.22</td>
</tr>
<tr>
<td>52-Week Low</td>
<td>$43.19</td>
</tr>
<tr>
<td>FY15E Revenue</td>
<td>$1,399</td>
</tr>
<tr>
<td>FY15E EBITDA</td>
<td>$182</td>
</tr>
<tr>
<td>FY15E EBIT</td>
<td>$104</td>
</tr>
<tr>
<td>FY15E Net Income</td>
<td>$64</td>
</tr>
<tr>
<td>FY15E Adj. EPS</td>
<td>$2.67</td>
</tr>
<tr>
<td>FY15E Operating Cash Flow</td>
<td>$147</td>
</tr>
<tr>
<td>FY15E Capex</td>
<td>$104</td>
</tr>
<tr>
<td>FY15E Share Repurchases</td>
<td>$97</td>
</tr>
<tr>
<td>FY15E Free Cash Flow</td>
<td>$43</td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>2.64%</td>
</tr>
</tbody>
</table>

Source: Bloomberg, Consensus Metrix

### REVENUES BY SEGMENT

- BEF Foods: 26%
- Bob Evans Restaurants: 74%

Market Cap: $1,161
Add: Debt: $374
Less: Cash & Notes: $21
Enterprise Value: $1,514

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STODGY, OLD COMPANY

As you know, we are big supporters of change at DRI and feel that BOBE is in a very similar situation. BOBE is a stodgy, old company that has flown under the radar for far too long. It has a history of mismanagement evidenced by flawed strategic rationale, excessively bloated cost structures and severe underperformance relative to peers. Its poor operating performance presents a tremendous opportunity.

UNLOCKING SIGNIFICANT SHAREHOLDER VALUE

We believe Sandell has identified significant, largely feasible, opportunities to enhance shareholder value. In our view, the opportunities are endless. More particularly, we see tremendous upside value in separating the foods business from the restaurant business, transitioning to an asset light model to capitalize on its vast real estate holdings, and attacking the middle of the P&L.

THE OTHER SIDE OF THE TRADE

We have a ton of respect for Sandell and the work they've done. In fact, we believe that, over time, they have uncovered far more than they originally set out to. As a result, there is now an opportunity for them to capture bountiful, low hanging fruit that will immediately impact the company for the better. We believe in Sandell’s resolve and while the street is seemingly betting against them, we’ll gladly take the other side of the trade.
CURRENT SITUATION
Over the past year, BOBE has underperformed the SPX and its Proxy Peers by 11% and 10% respectively.

PROXY PEERS: BH, BJRI, BWLD, CAKE, CBRL, DAVE, DENN, DIN, DPZ, DRI, EAT, FRS, HAIN, LNCE, MCD, MKC, PNRA, PZZA, RRGB, RT, SAFM, SJM, TAST, WEN, YUM.
MASSIVE UNDERPERFORMANCE

THREE-YEAR PRICE PERFORMANCE

Over the past three years, BOBE has underperformed its Proxy Peers by 26%.

PROXY PEERS: BH, BJRI, BWLD, CAKE, CBRL, DAVE, DENN, DIN, DPZ, DRI, EAT, FRS, HAIN, LNCE, MCD, MKC, PNRA, PZZA, RRGB, RT, SAFM, SJM, TAST, WEN, YUM.
Over the past five years, BOBE has underperformed the SPX and its Proxy Peers by 21% and 97% respectively.

**Proxy Peers:** BH, BJRI, BWLD, CAKE, CBRL, DAVE, DENN, DIN, DPZ, DRI, EAT, FRS, HAIN, LNCE, MCD, MKC, PNRA, PZZA, RRGB, RT, SAFM, SJM, TAST, WEN, YUM.

**Source:** Company Filings, CM Estimates

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Since 2011, management has consistently ramped up capex despite dismal returns. Take the Farm Fresh Refresh for example, which led to significant spending (~$225k per restaurant) with little to show for.
Since 3QF13, two-year same-restaurant sales have declined from +1.6% to -0.1%.

They are expected to fall to -1.2% in 4QF14.
This has led to a material decline in ROIIC.

Poor capital allocation = declining profitability.

‘Farm Fresh Refresh’ has been nothing short of a disaster.
Since 2011, management has consistently ramped up capex despite dismal returns.

BOBE can no longer fund its activities through operating cash flow generation.
Despite two years of declining returns, management plans to accelerate unit growth in the coming quarters. Accelerating unit growth in the face of deteriorating returns is a risky proposition.
ENTER SANDELL
Sandell Asset Management was founded in January 1998 by the Chairman and CEO, Tom Sandell, and has offices in New York and London.

Sandell is an asset management firm that specializes in event-driven, multi-strategy investing with a strong focus on special situations and credit opportunities.

The funds seek to identify the most fundamentally attractive hard-catalyst corporate events, wherever they may exist globally.

The firm's investment philosophy employs a best ideas approach, where capital is allocated opportunistically, and is dynamic with regard to geography or sector diversification.
THE BOBE TIMELINE

If you haven’t been following the Bob Evans / Sandell saga closely, we suggest you begin to. We like Sandell’s relentless resolve and believe they have identified several feasible opportunities to unlock shareholder value. As such, we believe BOBE represents an attractive entry point on the long-side. Before we run through our analysis, we thought it’d be helpful to provide a brief timeline of events below.

• **January 28, 2013 – Bob Evans Announces Agreement to Sell Mimi’s Cafe**
  After several years of underperformance, Bob Evans announces an agreement to sell Mimi’s Café to LeDuff America for $50 million. BOBE purchased the French-inspired casual dining restaurant for $183 million back in 2004. Under Bob Evans’ watch, Mimi’s Café hadn’t recorded an increase in same-store sales since 2005. [SEC Filing](#)

• **July 16, 2013 – Sandell’s Initial Discussion with CEO Steven Davis**

• **August 5, 2013 – Sandell Reaches Out to Lead Independent Director**
  Sandell sent a letter to Lead Independent Director, Michael Gasser, discussing key matters and potential ways to unlock significant shareholder value.
THE BOBE TIMELINE

• **August 19, 2013 – BOBE Announces Incremental $150 Million Share Repurchase Authorization**
  
  In its August 19th earnings release, Bob Evans announced an incremental $150 million share repurchase authorization. However, to Sandell’s dismay, the release made no other mention of the key matters addressed in its recent letter to Mr. Gasser. [SEC Filing](#)

• **September 23, 2013 – Sandell Recommends the Sale of BEF Foods**
  
  Sandell Asset Management, 5.1% owner of Bob Evans at the time, sent a letter to the company’s Board of Directors recommending the separation of BEF Foods through a sale or a spinoff. The activist also recommended management consider conducting a substantial sale-leaseback and implementing an aggressive share repurchase program. Sandell released a comprehensive investor presentation, highlighting its strategy to unlock significant shareholder value. Sandell estimated the stock could be worth $73 - $84 per share if its recommendations were put into action. The activist also called the recent four-year extension of Chairman and CEO Steven Davis an “ill-justified reward” for overseeing years of mismanagement and underperformance. [SEC Filing](#); [Sandell Presentation](#)

• **October 11, 2013 – Sandell Holds Discussion with Mr. Davis and CFO Paul Desantis**
  
  Mr. Davis assured Sandell the Board would review their ideas in “due time.”
THE BOBE TIMELINE

• **November 11, 2013 – Sandell Launches Proxy Fight**
  Sandell announced it retained a proxy solicitation firm, MacKenzie Partners. In the filing, Sandell noted it was “profoundly concerned by the Board’s lethargic approach to taking action to enhance shareholder value” and criticized the Board for its apparent indifference. Sandell cited its intent to explore a consent solicitation in order to seek change. [SEC Filing](#)

• **December 4, 2013 – Dismissive Comment by CEO Davis on 2QF14 Earnings Call**
  In his comments, Mr. Davis rebuffed Sandell’s three principal ideas including its call for a sale leaseback, a spinoff of BEF Foods and accelerated share repurchases. [Transcript](#)

• **December 9, 2013 – Sandell Announces Intent to Commence a Consent Solicitation**
  Sandell, owner of 6.5% of BOBE at the time, released a letter stating its intention to seek a consent solicitation. In the letter, the activist claimed it has been met with “near indifference” by management and the Board of Directors. Sandell also denounced the Board for its “history of inaction” and highlighted what it believes to be the “strategic irrationality” of operating a restaurant and packaged foods business under the same corporate umbrella. [SEC Filing](#); [Sandell Presentation](#)
THE BOBE TIMELINE

- **January 14, 2014 – Sandell Sues Bob Evans**
  Sandell filed a lawsuit against Bob Evans after the Board of Directors voted to require a supermajority (80% of shareholders) to make bylaw changes. This change came back in 2011, just three months after shareholders voted to reduce the company’s bylaws to only require a simple majority to affect change. In a separate lawsuit, the Oklahoma Firefighters Pension & Retirement System also accused Bob Evans of raising the threshold for bylaw changes without the approval of, and against the desire of, shareholders. [SEC Filing](#)

- **January 28, 2014 – Bob Evans Amends Bylaws**
  Facing significant legal pressure, the Board of Directors amended Bob Evans’ bylaws to allow a simple majority of shareholders the ability to affect change. The company also revealed in a press release that one, and up to three, new independent directors would be appointed to the Board prior to the 2014 Annual Meeting. [SEC Filing; Amended Bylaws](#)

- **January 29, 2014 – Sandell Comments On Reversal, Blasts Board**
  Sandell publicly announced that it was pleased with the Board’s decision to reverse an ill-advised bylaw amendment and planned to withdraw its lawsuit. Despite this, Sandell went on to voice its continued displeasure with the highly conflicted Board, referring to it as “one of the most insidious examples of cronyism demonstrated by a publicly-traded company.” [SEC Filing](#)
THE BOBE TIMELINE

February 25, 2014 – Industry Expert Becomes Critical of BOBE

Jonathan Maze of Restaurant Finance Monitor wrote an article titled “How Restaurant Companies Should React To An Activist” in which he criticized the way Bob Evans has dealt with Sandell Asset Management. The article features Chris Davis, chair of the Investor Activism Group for Kleinberg, Kaplan, Wolff and Cohen, who had the following to say about the Board’s dismissive tactics: “That is, in 2014, just an ill-advised play by management. To completely stonewall an activist is the height of poor judgment.” Article (excerpt below)

The Bad: Bob Evans. Sandell Asset Management took an activist position in the Ohio-based family dining chain last year, and then quickly pushed for major changes, including a spinoff of the company’s food products division. In response, Bob Evans said ... nothing.

It wasn’t until after Sandell said it planned on using an aggressive strategy, known as a consent solicitation, to push for changes before the company’s annual meeting, that Bob Evans responded to Sandell’s proposal on its merits. (The company largely dismissed the ideas, which also include a sale of real estate, as “financial engineering.”)

That wasn’t the right move. “That is, in 2014, just an ill-advised play by management,” Davis said. “To completely stonewall an activist is the height of poor judgment.”

It’s particularly poor judgment considering that Bob Evans shareholders haven’t exactly been thrilled with the company over the years. For years, for instance, shareholders had been trying to lower the voting threshold to make major changes at the company to a simply majority, from 80 percent, and finally succeeded in 2011. Bob Evans’ board changed it back to 80 percent three months later—a decision subject to lawsuits from Sandell and a pension fund earlier this year. Bob Evans has since given in and returned the threshold to where it was.
April 24, 2014 – Sandell Nominates Eight Independent Directors

Sandell released a letter in which it identified and nominated eight independent candidates to Bob Evans’ Board of Directors. The nominations include a wide range of talented, proven leaders with varying specialties:

- Doug Benham: Former President and CEO of Arby’s Restaurant Group
- Charles Elson: Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware
- David Head: Former President and CEO of O’Charley’s Inc.
- Steve Lynn: Former Chairman and CEO of Sonic Corporation
- Annelise Osborne: Senior Credit Officer at Moody’s Investor Service
- Aron Schwartz: Former Managing Director at Fenway Partners
- Michael Weinstein: Former CEO of Triarc Beverage Group (Snapple Beverage Group)
- Lee Wielansky: Chairman and CEO of Midland Development Group

Sandell also released its most comprehensive presentation yet, which highlights Bob Evans’ underperformance, the Board’s history of inaction and opportunities to unlock significant shareholder value. SEC Filing; Sandell Presentation
THE BOBE TIMELINE

• April 28 – BOBE Appoints Three New Board Members
  Shortly after Sandell’s nominations to the Board, BOBE appointed the following individuals to its Board of Directors: Kevin Sheehan, President and CEO of Norwegian Cruise Line, Kathy Lane, former CIO of TXJ Companies and Larry McWilliams, Co-CEO of Compass Marketing. The company also announced the retirement of two long-standing directors, Larry Corbin and G. Robert Lucas and the resignation of West Virginia University President Gordon Gee. SEC Filing

• April 28 – Sandell Responds to BOBE’s ‘Knee-Jerk Reactionary’ Moves
  Sandell referred to the aforementioned Bob Evans’ announcement as a “half measure,” stating it was taken as a “knee-jerk reactionary” response to significant outside pressure. In a press release, Tom Sandell delivered a damning interpretation of the move saying: “In our view, this is yet another cynical attempt by the Board of Directors of Bob Evans to pose as a Company that embraces good governance after forcing shareholders to suffer years of underperformance under the supervision of what we view as a stale and entrenched Board.” Sandell also stated that its nominees compare favorably to the three newly appointed Board members. SEC Filing

• May 7 – BOBE Chief Financial Officer, Paul F. DeSantis, Resigns
  DeSantis resigned effective as of May 16, 2014 and will be moving on to another company. The company’s VP of Corporate Development and Finance, T. Alan Ashworth, will serve as interim CFO.
THE SIMILARITIES ARE STRIKING

- Combined Chairman and CEO position
- Stale and entrenched Board of Directors
- New, opulent headquarters
- Corporate plane
- Excessive G&A spending
- Significant non-core business
- Inefficient remodel program
- Lackadaisical management

Chairman and CEO Steven Davis

Bob Evans’ lavish new headquarters in New Albany.
“...We have reached the inescapable conclusion that the Company suffers from numerous problems stemming from one central issue: a stale and entrenched Board of Directors that has not, in our view, exerted effective oversight over a management team led by the Company’s Chairman of the Board and CEO Steven Davis. We believe this is due in large part to the many long-standing personal and inter-twined relationships among Mr. Davis and other Directors.” - Thomas Sandell, Chairman & CEO of Sandell Asset Management (April 24, 2014)
THE OPPORTUNITIES ARE REMARKABLY APPARENT

We’ve spent a significant amount of time working through Sandell’s investment thesis and believe that the vast majority of their findings and proposals to enhance shareholder value at Bob Evans Farms are highly relevant and feasible. Having said that, our suggestions are quite similar to Sandell’s but we’d like to particularly emphasize one thing: transitioning to an asset light model.

Our thesis centers on four critical themes:

1. Separating the foods business from the restaurant business
2. Improving store operating performance by moving to an asset light model
3. Scrutinizing capital allocation and attacking the middle of the P&L
4. Capitalizing upon the real estate opportunity
#1. SPINOFF BEF FOODS

**TIME TO MOVE ON**
The food processing business is linked to the founding of the company and, to be clear, we fully appreciate the desire to maintain tradition within a business. With that being said, we believe this connection is severely limiting the potential of the company.

**FEW, IF ANY, SYNERGIES**
Other than the historic connection between the BEF Foods and Bob Evans Restaurants, there are very few synergies between the businesses. We believe that each business would benefit greatly from laser-focused, uncompromised operating strategies.

**BETTER SERVED INDEPENDENTLY**
In our view, BEF Foods would fare far better as an independent company, separate from Bob Evans Restaurants. A separation would allow BEF Foods to increase sales in the foodservice industry and further diversify its customer base, giving it substantial runway for growth.
EACH OPERATING BUSINESS WOULD BENEFIT GREATLY FROM A SPINOFF

• BEF Foods’ sales to the foodservice business (including other restaurants) only accounts for 20% of revenues. We believe very few, if any, restaurants are compelled to buy product from a competitor. In FY13, the 10 largest customers represented approximately 60% of BEF Foods’ total revenues. The top two customers represented approximately 30% of BEF Foods’ revenues. There is substantial room for growth and diversification.

• We also believe the foods business is lacking operational focus and severely limiting the restaurants business. There seems to be a never-ending stream of issues and excuses linked to BEF Foods. Take these comments from CFO Paul DeSantis, on the most recent earnings call, for example:

“The dispute with a certain BEF Foods supplier continued through December. We estimate lost profitability of approximately $2.5 million or $0.08 per diluted share. The primary driver of lost profitability has been the sales effect as we shorted customer orders due to lack of capacity.”

“Also, contributed to the shortfall last year is the slower than expected startup at our Sulphur Springs facility expansion… The startup complexity was higher than anticipated resulting in higher waste and labor costs in the quarter.”

“High sow costs also had an impact on the quarter compared to last year. Sow costs were $4.5 million unfavorable…”

“…incremental severe winter weather and higher-than-expected startup inefficiencies at Sulphur Springs contributed to approximately $0.11 per diluted share in EPS shortfall.”
A recent surge in BEF Foods’ cost of sales has hurt the overall profitability of the company.

TTM Food Costs as a % of Sales for BEF Foods has increased 344 bps since 4QF13.
LABOR COSTS CONTINUE TO PRESSURE MARGINS

TTM Labor Costs as a % of Sales for BEF Foods has increased 236 bps since 1QF13.
OTHER EXPENSES ARE UP SIGNIFICANTLY SINCE THE BEGINNING OF FY12

TTM Other Expenses as a % of Sales for BEF Foods has increased 366 bps since 4QF11.

Source: Company Filings, CM Estimates

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WITH EXPENSES STEADILY INCREASING YEAR AFTER YEAR, OPERATING MARGINS HAVE MATERIALLY DELEVERED

TTM Operating Profit as a % of Sales for BEF Foods has decreased 469 bps since 1QF12.
#2. TRANSITION TO AN ASSET LIGHT MODEL

SIGNIFICANT REAL ESTATE HOLDINGS

Bob Evans’ real estate holdings give management the ability to convert to an asset light model in order to significantly enhance shareholder value. In the restaurant space, franchisees have been known to run restaurants better than the franchisors running the brand. We believe this will hold true in the case of BOBE and imagine there would be enough appetite to sell off large blocks of stores.

COMPETITORS GET IT

There have been a number of public companies that have pioneered such a transition in the restaurant industry. In this presentation, we highlight JACK as one of the most recent companies to do this – but it is far from the only success story. Two direct competitors in the family dining segment, Denny’s (DENN) and IHOP (DIN), are nearly 100% franchised. Burger King (BKW) has also made an aggressive push to an asset light model. Finding a few strong franchise partners would help BOBE address its numerous operational issues.

DIVERSIFY THE REVENUE STREAM

An overwhelming number of Bob Evans Restaurants are located in Ohio and other parts of the Midwest. BOBE has 241, or approximately 43%, of its restaurants in Michigan and Ohio. We believe BOBE will command a higher valuation by selling off a number of stores in the Midwest and diversifying its revenue stream.
TRANSITION TO AN ASSET LIGHT MODEL

FIXING WIDESPREAD OPERATIONAL ISSUES

• Finding a few strong franchise partners would help the Bob Evans brand effectively address some of the operational issues currently plaguing the company.

• The most obvious example of operational incompetence is an average check that is far too high. Average per-guest checks in FY13 for breakfast, lunch and dinner were $8.47, $9.24 and $9.07, respectively. We believe this is, to an extent, a traffic deterrent. Assuming BOBE has loyal breakfast customers, we believe the $9.24 average lunch check is not nearly as competitive as it should be in today’s environment. The big, national casual dining chains are currently promoting $6 to $7 price points for lunch on National TV.

• Denny’s CEO John Miller spoke precisely to this process on the company’s most recent earnings call:

  “We will continue to work closely with our franchisees in identifying opportunities to reinforce the traffic and frequency driving aspects of the $2, $4, $6 and $8 Value Menu, while continuing to look for ways to improve food costs, margins, flow-through and ultimately store level profits.”
JACK REFRANCHISING

THE TRANSITION TO AN ASSET LIGHT MODEL

JACK’s transition to an asset light model has reaped significant rewards for long-term shareholders.
TIGHTER INTERNAL CONTROLS = LESS WASTE

Labor Costs as a % of Sales are down 310 bps since 1Q11.

Source: Company Filings, CM Estimates

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TIGHTER INTERNAL CONTROLS = LESS WASTE

Other Expenses as a % of Sales are down 208 bps since 1Q11.
LESS WASTE = HIGHER PROFIT MARGINS

Restaurant Level Profit as a % of Sales is up 570 bps since 1Q11.
LESS WASTE = HIGHER PROFIT MARGINS

Operating Profit as a % of Sales is up 449 bps since 1Q11.
JACK’S stock price is up 178% since the beginning of 1Q10, which marked an inflection point in its company-to-franchise restaurant mix.
SIGNIFICANT PROFIT POTENTIAL

In an asset light model, we believe BOBE would be able to collect as much as 10-12% of revenues in rent and royalty on a per store basis. This compares favorably to the current 7% operating margin. In addition, we estimate the company could generate $300 to $600 million pre-tax in asset sales. The cash generated would allow the company to reduce its current outstanding share count by 20-30%.

<table>
<thead>
<tr>
<th>BOBE ASSET LIGHT PROFIT POTENTIAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total System-Wide Restaurants</strong>  562</td>
</tr>
<tr>
<td><strong>Re-Franchised Units</strong>            482</td>
</tr>
<tr>
<td><strong>Company Owned Units</strong>            80</td>
</tr>
<tr>
<td><strong>Rent from Re-Franchised Restaurants</strong> $ 62.2</td>
</tr>
<tr>
<td><strong>Royalty on Re-Franchised Restaurants</strong> $ 33.2</td>
</tr>
<tr>
<td><strong>Potential Asset-Light Operating Profit</strong> $ 95.34</td>
</tr>
<tr>
<td><strong>Owned Restaurant Operating Profit</strong> $ 12.38</td>
</tr>
<tr>
<td><strong>Asset-Light BOBE Operating Profit</strong> $ 107.72</td>
</tr>
<tr>
<td><strong>Asset-Light BOBE Operating Margin</strong> 34.4%</td>
</tr>
<tr>
<td><strong>TTM BOBE Operating Profit</strong>       $ 65.23</td>
</tr>
<tr>
<td><strong>TTM BOBE Operating Margin</strong>       6.0%</td>
</tr>
<tr>
<td><strong>% Upside in Operating Profit</strong>    65.1%</td>
</tr>
</tbody>
</table>

Source: Company Filings, Hedgeye Estimates

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#3. REFOCUS CAPITAL ALLOCATION

EXCESSIVE AND ILL-ADVISED SPENDING
Management’s loose and unaccounted for spending habits have been a material detriment to the profitability of the company. Farm Fresh Refresh remodels have been a disaster, essentially eviscerating returns on incremental invested capital. Now, management has a Farm Fresh Refresh 2.0 planned. Negative returns aren’t cool and BOBE’s industry-leading SG&A spend is simply inexcusable.

DECLINING PROFITABILITY
As we pointed out earlier in the deck, returns have plummeted while capital spending has skyrocketed. This has resulted in a significant decline in the company’s profitability. Most operating metrics have either been stagnant or declining for the last several years. The storytelling is over. BOBE is on a disastrous path and needs a serious shakeup.
DISMAL OPERATING RESULTS

THE COMPANY’S OPERATING INITIATIVES ARE NOT “PAYING” OFF
DISMAL OPERATING RESULTS

OPERATING INCOME AND MARGIN HAVE BEEN STAGNANT SINCE FY09

Source: Bloomberg
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Source: Bloomberg
© HEDGEYE RISK MANAGEMENT
DISMAL OPERATING RESULTS

EPS GROWTH ON A TWO-YEAR BASIS HAS STEADILY DECLINED SINCE FY11

Source: Bloomberg

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EXCESSIVE SG&A SPEND

MANAGEMENT MUST ATTACK THE EXCESSIVE SG&A SPENDING

On average, casual dining operators have SG&A as a % of Sales of 8.73%.

This makes BOBE’s 13.25% looks egregious in comparison. We believe there is significant room for improvement.
#4. UNLOCK REAL ESTATE VALUE

SALE-LEASEBACK ANALYSIS

We outline our real estate analysis in the table below. Our valuation assumes an incremental rent expense equal to 6.0% of owned restaurant revenue that is capitalized at a 7.0% cap rate, which is conservative when compared to recent restaurant sale-leaseback transactions. As a result, our analysis works out to a value of $1.47 million per owned restaurant, which is significantly below the company’s stated cost to build a new restaurant.

<table>
<thead>
<tr>
<th>SALE-LEASEBACK ANALYSIS</th>
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<tbody>
<tr>
<td>Average Revenue Per Restaurant ($MM)</td>
</tr>
<tr>
<td>Number Of Owned Restaurants</td>
</tr>
<tr>
<td>Est. &quot;Owned Restaurant&quot; Revenue</td>
</tr>
<tr>
<td>Est. Additional Rent Exp. @ 6%</td>
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<tr>
<td>Est. Cap Rate in Sale-Leaseback</td>
</tr>
<tr>
<td>Proceeds From Sale-Leaseback</td>
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<tr>
<td>Value Per Restaurant ($MM)</td>
</tr>
<tr>
<td>BOBE Enterprise Value</td>
</tr>
<tr>
<td>Proceeds as a % of EV</td>
</tr>
</tbody>
</table>

*This analysis excludes BOBE’s new corporate headquarters and other properties which we estimate could generate an additional $80 to $100 million in proceeds.*
VALUATION & SENTIMENT
Admittedly, the stock isn’t particularly “cheap” to the naked eye.

However, given the current situation and channels for potential value creation, we think today’s price offers an attractive entry point.
The sell-side has become increasingly bearish since the beginning of 2014.

To be fair, we’d be bearish as well if an activist weren’t in the picture – but that’s simply not the case.
SHORT INTEREST HAS INCREASED IN EACH OF THE LAST FOUR MONTHS

We’re surprised to see sentiment has turned decidedly against Sandell.

We’ll happily take the other side of that trade.
WHAT'S BOBE WORTH?
### SCENARIO 1: CUT EXCESS SG&A

A 300 bps reduction in SG&A as a % of Sales in FY15 would give BOBE an extra $1.22 of earnings, resulting in $3.89 in EPS. This is 46% higher than the current FY15 EPS estimate of $2.67.

#### SG&A REDUCTION ANALYSIS

<table>
<thead>
<tr>
<th>SG&amp;A as a % of Revenue</th>
<th>10.25%</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2015 EPS</td>
<td>$ 2.67</td>
</tr>
<tr>
<td>FY2015 Net Income</td>
<td>$ 62.40</td>
</tr>
</tbody>
</table>

**Pro-Forma Adjustments**

<table>
<thead>
<tr>
<th>SG&amp;A Savings</th>
<th>41.91</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax (31.5%)</td>
<td>13.20</td>
</tr>
<tr>
<td>Net Income Improvement</td>
<td>28.71</td>
</tr>
<tr>
<td>EPS Improvement</td>
<td>$ 1.22</td>
</tr>
</tbody>
</table>

| FY15 Shares Outstanding | 23.44 |

<table>
<thead>
<tr>
<th>Pro-Forma Net Income</th>
<th>$ 91.11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro-Forma EPS</td>
<td>$ 3.89</td>
</tr>
</tbody>
</table>

Current FY15 EPS $2.67

| % Upside | 46% |

<table>
<thead>
<tr>
<th>*Share Price</th>
<th>$ 69.96</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Upside to Current</td>
<td>49%</td>
</tr>
</tbody>
</table>

*Assuming 18x P/E Multiple © HEDGEYE RISK MANAGEMENT
There is tremendous value to be had if BOBE were to make the appropriate SG&A cuts and spinoff BEF Foods.

### CUT SG&A/SPINOFF BEF FOODS ANALYSIS

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>After Tax Proceeds from Sale</td>
<td>$169.05</td>
</tr>
<tr>
<td>Shares Repurchased @ $48 (MM’s)</td>
<td>$3.52</td>
</tr>
<tr>
<td>Remaining Shares Outstanding (MM’s)</td>
<td>$21.48</td>
</tr>
<tr>
<td><strong>Restaurant Level Cash Flow</strong></td>
<td>$192.52</td>
</tr>
<tr>
<td>G&amp;A @ 4.0%</td>
<td>$38.50</td>
</tr>
<tr>
<td>D&amp;A</td>
<td>$48.13</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>$105.89</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>$4.00</td>
</tr>
<tr>
<td>Pre-Tax</td>
<td>$101.89</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$76.41</td>
</tr>
<tr>
<td>EPS</td>
<td>$3.56</td>
</tr>
<tr>
<td>P/E Multiple</td>
<td>22.0x</td>
</tr>
<tr>
<td><strong>Stock Price</strong></td>
<td>$78.26</td>
</tr>
<tr>
<td><strong>Potential Upside</strong></td>
<td>66.5%</td>
</tr>
</tbody>
</table>

Source: Company Filings, Hedgeye Estimates

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SUMMARY

A HISTORY OF MISMANAGEMENT

A conflicted, compromised Board in tandem with seemingly incompetent management has resulted in wasteful spending, declining returns and massive underperformance. We believe the current structure of the company is severely limiting its two, distinctly different operating businesses.

POTENTIAL FOR SIGNIFICANT VALUE CREATION

Massive underperformance and stagnant operating trends present a significant opportunity for value creation at the company. Specifically, we believe the company would benefit from a spinoff or sale of BEF Foods, a transition to an asset light model to capitalize upon its notable real estate, and refocused capital allocation.

WHAT’S NEXT?

Sandell and Bob Evans have been in a tug-of-war since early last year. The company has generally resisted change, but with the recent board shakeup and the resignation of CFO Paul DeSantis, we believe the activist is beginning to build considerable momentum. We have a ton of respect for Sandell and the work they’ve done. If they are successful in inspiring or forcing material change, shareholders will reap significant rewards.