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# Ruby Tuesday Inc

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**SECTOR** Services
**INDUSTRY** Restaurants
**FULLTIME EMPLOYEES**: 28,900

**PROFILE** Ruby Tuesday owns, operates and franchises a chain of American-style casual dining restaurants in the US and abroad.

**ANALYSIS** Ruby Tuesday net income losses were over $100 million in the last 12 months. Same store sales continue to rapidly deteriorate. Quality across the board has declined. The only positive aspect of Ruby Tuesday Inc. is its vast real estate portfolio. A Ruby Tuesday REIT would be worth $741 million or $12.24 per share, which is nearly 6.44 times what the Ruby Tuesday Inc. current price is today.

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## Executive Summary

Ruby Tuesday is a chain of American-style casual dining restaurants. Recently this segment of the restaurant market has been adversely impacted by the rise in popularity of fast casual restaurants. Ruby Tuesday has been particularly hard hit due to self inflicted injuries by its management. Furthermore, Management has shown that it is incapable of leading stores to success; with a quick glimpse at Ruby Tuesday's social media you can see that the company receives significant negative press for its poor customer service, hostile servers, tables flipped over, long waits and overall unsatisfactory cleanliness. As a result, Ruby Tuesday is now facing a bleak future.

Ruby Tuesday spends more on its employees as a percent of revenue than its competitors do. While this could be viewed as a consequence of aggressive cost-saving methods, Ruby Tuesday actually underperforms its competitors in every area examined. Ruby Tuesday has not had an annual profit in 5 years, with the losses accelerating to nearly $100 million in 2015, nearly 1/4 of its enterprise value. Historically, Ruby Tuesday management has followed a weak sales report with a large capex investment to remodel their stores and brand. This time, however, management has decided on a modest reinvestment plan, suggesting that they believe this storm will blow over. With long time customers literally fleeing the brand, escalating costs, and a declining casual dining market, the outlook for Ruby Tuesday is extremely grim.

However, a silver lining exists: Ruby Tuesday has a wide portfolio of commercial property assets that could be worth as much as $507 million. Splitting these assets into a separate entity would give shareholders a fair and final large yield, while speeding up the inevitable Ruby Tuesday bankruptcy. Using comparables, $507 million of property assets could be worth nearly $956 million less $215 million in debt, approximately $12.24 per share. Alternatively, if Ruby Tuesday decides not to spin off its assets, and conditions do not improve, Ruby Tuesday will burn its asset portfolio within 3-5 years.

## Economic Environment

Since the financial crisis of 2008, several long term social and economic trends have emerged in the United States that impact Ruby Tuesday's business. These trends include wealth distribution, unemployment and labor force participation rates, consumer sentiment, minimum wage and commercial real estate trends.

**Wealth Distribution:** After the financial crisis, the average American's wealth dropped 40%. During the recovery, wealthier people were able to afford more investments, which in turn meant that they recovered at a faster rate than the average American. In fact, now "one in seven Americans – 46 million people – rely on food pantries and meal service programs to feed themselves and their families."[1] This is a problem for Ruby Tuesday as it caters to the lower end of the casual dining cost spectrum, choosing to focus on greater affordability as opposed to higher quality when compared to its peers. Thus as the wealth gap continues to divide Americans, Ruby Tuesday's target customer base shrinks and its business plan is destroyed.

**Workforce Utilization:** Unemployment is at the lowest rate since the 2008 financial crisis. According to FRED, the Unemployment Rate is 4.8%, down from nearly 10% in middle of the financial crisis. At the same time, the Labor Force Participation Rate is 62.9%, down from approximately 66% participation from 1988 through 2008. The drop in participation is often explained as a result of an increase in workers entering retirement during the financial crisis. What this means for Ruby Tuesday is that as the labor supply decreases, the company may end up paying more for the same employees, increasing total costs. Labor is already an issue for Ruby Tuesday, as it spends more than its peers as a percent of revenue.

**Consumer Sentiment:** Consumer Sentiment after the financial crisis of 2008 peaked in January of 2015, at 98 points. Since then, consumer sentiment has decreased slightly to 95.7 points as of April 2016. An Index above 50 means consumers are slightly positive about their financial future, and 100 is the maximum score. This indicates that although consumers are extremely positive on their personal current and future financial standing, that positive outlook has been deteriorating since January 2015. Ruby Tuesdays is a premium good, because families can cook more cheaply at home, and will be affected by future sways of the consumer sentiment.

**Minimum wage:** Currently there is large momentum in the U.S. for a flat $15 minimum wage. Casual dining restaurants use extensive labor, which means that a $15 minimum wage could be detrimental to potential profit margins. Our analysis shows that Ruby Tuesday has begun to pull out of states which are increasing their minimum wages drastically.

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[1] DiBlasio, Natalie. "Hunger in America: 1 in 7 Rely on Food Banks." *USA Today*. Gannett Satellite Information Network, 17 Aug. 2014. Web. 21 Feb. 2017.

**Commercial Real Estate:** According to the National Association of Realtors, commercial property vacancy rates in 2016 were 11.87%. This is expected to decrease in 2017 to 10.9%. Green Street advisors also estimate that the average rent in 2017 will increase 2.7% over that of 2016.

## Industry Analysis

The casual dining industry consists of mid-priced, sit-down restaurants with unique atmospheres, where customers are served at their tables by wait staff. Restaurants in this category include Olive Garden, Applebee's, Logan's Roadhouse and Chili's. Menus typically include appetizers, main dishes, sides, desserts and beverages, including alcohol.

Casual dining requires significantly more labor than fast casual dining. The kitchens produce a wider variety of food items and thus are less efficient. It takes extra staff and time to bring food to the customers' tables than it does to have the customers pick it up at a counter themselves. This additional labor means higher costs for the operation, as well as higher costs for the customer since he has to add a tip to the cost of his food. Additionally, there is considerable momentum across the nation now to raise the minimum wage to $15 per hour, which will further increase labor costs.

The casual dining industry is approaching $1 trillion in yearly sales, but it is under stress due to increasingly slimmer margins and increased competition. Competition has always been a challenge, but recently this has gotten worse. The Millennial generation prefers fast casual over casual dining, and Millennials are quickly becoming the cohort that spends the most money eating out. "Although Millennials told us they often go to casual-dining restaurants such as Olive Garden, Applebee's, Chili's and The Cheesecake Factory, they tend to prefer fast-casual options such as Panera Bread, Chipotle Mexican Grill and Pei Wei Asain Diner."[2] BCG also noted that Millennials prefer to eat out during off peak hours twice as much as previous generations, and prefer great tasting, high quality food that is convenient. Unfortunately for casual dining establishments, this means the Millennials prefer the quicker, high-quality fast casual options such as Chipotle. If the casual dining restaurants want to survive, they must adapt to the needs and wants of the Millennial generation.

Many players in the casual dining industry are being driven under by rising labor and food costs and this competition with the fast casual industry for the Millennial consumer. In recent months, several casual dining restaurants have been forced to close their doors. These include Logan's Roadhouse Steaks (230 locations) and Rita Restaurant Corp, which owned multiple smaller casual dining brands consisting of over 100 locations. A Jeffries report indicated that same store sales across the casual dining industry fell 1.2% in 2015, and .8% in 2016 and that the decline in sales will continue for at least the next 18 months.[3] In the same report, Jeffries highlighted how tough the competition is: In 2002, there were 475,000 eating and drinking establishments in United States. Now there are 600,000 restaurants — a net increase of 26%, while during the same time the net population in the United States increased by only 12%.

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[2] Boston Consulting Group, *Millennial Passions: Food, Fashion, and Friends.* https://www.bcg.com/documents/file121010.pdf

[3] Jeffries, *Restaurants Calling the Top of the Restaurant Cycle; Incremental Caution Required* https://www.jefferies.com/CMSFiles/Jefferies.com/files/Insights/Restaurants.pdf

Many casual dining restaurant chains own a large number of their physical properties, as opposed to leasing them. Leases are more commonly found with the majority of fast casual establishments. Casual dining restaurants purchased many properties in the 1970's when land was relatively cheap. As property is now much more valuable, many activist funds are encouraging companies with large retail assets to actively spin the assets off. This returns value to the shareholder as the value of the two companies separated is larger than the two together.

Darden, the owner of Olive Garden, recently completed a REIT spin off, transferring some of its assets to a new company called Four Corner's Property Management. The deal created nearly $20 per share, increasing shareholder value by 25%.

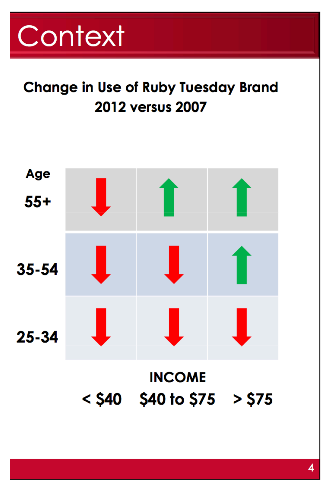
## Company Description

Ruby Tuesday Inc. is a large multinational corporation that owns, operates and franchises Ruby Tuesday-branded casual dining restaurants. The company currently owns 546 locations, with its main markets being the “Southeast, Northeast, Mid-Atlantic, and Midwest of the United States.” (10-k) Franchise operations span over 76 locations and multiple countries, but only make up a tiny portion of Ruby Tuesday’s revenue. Each Ruby Tuesday restaurant serves approximately 350-400 customers per day with an average check size of $11.50[4]. The cuisine is American and the restaurant serves lunch and dinner.

Ruby Tuesday is known for its famous salad bar, dubbed the Garden Bar, but also has a large menu of carbo-loaded offerings and a full bar. Approximately half of all customers will utilize the Garden bar during a visit, and this separates Ruby Tuesday from most of its competition. Within the last two months Ruby Tuesday has substantially raised its menu prices across the board (garden bar plate increased nearly 20%), and this will be noticeable in the next earnings release. Ruby Tuesday is in direct competition with TGI Fridays, BJ’s and Applebee’s. When compared to these competitors, Ruby Tuesday serves a lower quality meal to a less affluent customer base at a lower price.

In recent years Ruby Tuesday has struggled to make a profit. A combination of firm-specific and industry-specific events have contributed to Ruby Tuesday’s downfall.

Ruby Tuesday’s profit margin has been destroyed by rising costs and lower sales. As wages rose, the company saw increases in both the cost of their employees and the cost of their ingredients. While restaurants typically pay lower than minimum wage due to tipping, wage hikes still increased their labor costs. At Ruby Tuesday, COGS and labor as a percent of sales rose from 27% to 29% and 33% to 37% respectively over the last 2.5 years. As labor costs continue to rise across the board, casual dining restaurants are forced to raise their prices, which in turn edges out the lower income end of customers. This macro end effect impacts Ruby Tuesday more significantly than its competitors, as Ruby Tuesday caters to this lower income class. Not only is Ruby Tuesday losing its largest customer base, but it also is failing to adapt to a newer generation’s tastes.




Ruby Tuesday is not popular among Millennials, and its failure to adapt is causing a shift in its customer base. Ruby Tuesday states that their target market is 25-40 year old women with young families. However, marketing data in this slide distributed in their latest presentation to investors highlights that the vast majority of Ruby Tuesday’s customers are middle class senior citizens. Ruby Tuesday’s declining sales are most likely because younger people do not enjoy eating there, and they are quickly

[4] Segal, David. "At Ruby Tuesday, Casual Dining Dons a Blazer." The New York Times. The New York Times, 07 Nov. 2009. Web. 21 Feb. 2017.

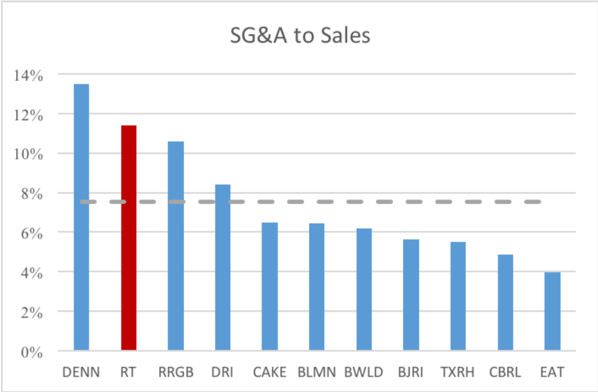
becoming the largest segment of the market. This shift, as noted above in the industry analysis, is likely because Millennials prefer fast casual restaurants, and Ruby Tuesday's concept is outdated. Morgan Stanley agrees with this logic in the shift of tastes. A recent survey published by them in 2014 noted that casual dining's core customers are between the ages of 50 and 68 years old. Just because Ruby Tuesday wants 25-40 year old women to be their core customers does not make it so. The fact that Ruby Tuesday management is unable to understand their own target market highlights their inability to make appropriate and relevant business decisions. Ruby Tuesday's same-store restaurant sales have fallen an average of nearly 2% for the last three years.

Meanwhile, Ruby Tuesday's average check size has lagged that of the industry, staying level at approximately $11.50 since 2009. Excessive coupon promotions bring return customers, but often at too low of a price. A quick Google search reveals plenty of offers for 25% off an entire order, as well as many "Buy one, get one free" offers. In an attempt to reverse both the negative trend of customers and the average check size, the company is making several major changes.

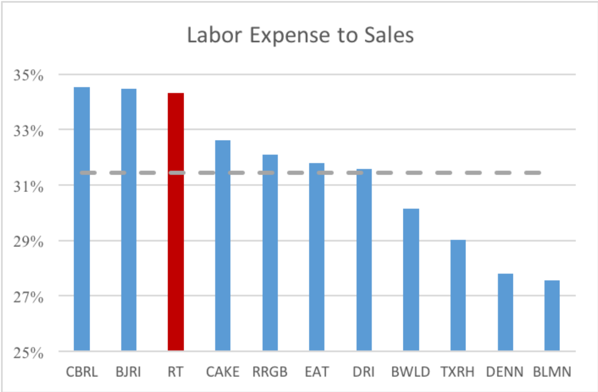
Ruby Tuesday is in the midst of an identity crisis, and doesn't seem to recognize it. Management does not know its customer base and its brand is unattractive to the newest, and highest spending generation. Its profits are plunging, and there is little hope for any turnaround in the future.

## Ruby Tuesday vs. Peers

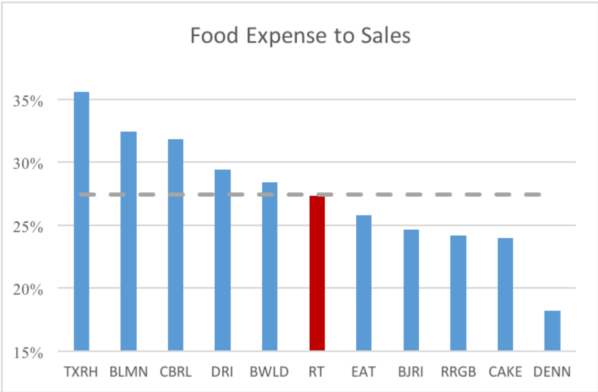
As the casual dining restaurant segment growth continues to stall out compared to that of the fast casual segment, Ruby Tuesday is also stalling out compared to its peers with respect to controlling its costs.




Ruby Tuesday has a significantly higher SG&A expense than its peers, roughly 400bps higher. This is most likely due to inefficiencies spent on marketing. Ruby Tuesday's recent marketing campaign featured a middle-aged woman singing about the new salad bar. It failed spectacularly, generating social media comments that even asked the company to stop using the ad. Perplexedly, despite the closing of nearly 20% of stores between November '15 and November '16, Ruby Tuesday actually increased the overall amount it spent on marketing. Ruby Tuesday also issues a large number of coupons to its customers, which further cut back revenue from loyal customers.

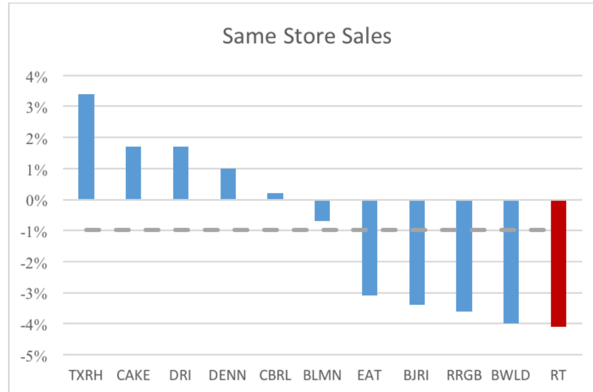



Ruby Tuesday's labor expense, 34.3% of sales, is approximately 300 basis points above that of its peers. This implies that it has significant operating inefficiencies. Customer comments online also denote dissatisfaction with employees. Customers complained about everything, from the way servers talk to customers to how some servers were distracted by their phones. A commenter even posted a video of a mouse running around tables in the front of the store. Management needs to crack down on its labor staff if it wants to make a profit.




An area where Ruby Tuesday does shine compared to its peers is its food expense to sales ratio, which is under its peers by 15bps. The food served at Ruby Tuesday is generally of a lesser quality than that of its peers, which explains why Ruby Tuesday's food expense is lower then its peers. Most likely, Ruby Tuesday's food expense should be even lower then where it is now.

Finally, the measure that most clearly shows Ruby Tuesday's underperformance when compared to its peers is its same store growth.  Ruby Tuesday's latest numbers show a shocking 300bps gap between Ruby Tuesday's performance and that of its peers.  Despite more marketing per store, increased costs, and stagnant revenue per customer, customers are fleeing Ruby Tuesdays faster than ever.




The fact that Ruby Tuesday lags far behind its competition on multiple comparables clearly illustrates that it is time for new leadership.  Management has developed a new fresh start initiative to address the situation.  Unfortunately this approach seems to be too little, and too late.

## Fresh Start Initiative

Ruby Tuesday shares are at an all time low. Net income losses were over $100 million in the last 12 months. Same store sales continue to rapidly deteriorate. Quality across the board has declined. Ruby Tuesday's management clearly sees the writing on the wall, and is attempting to stop the ship from sinking at all costs. Their solution is called the Fresh Start Initiative, and focuses on cutting costs, improving quality, and implementing long overdue changes.

To refocus the brand solely on Ruby Tuesday, the corporation diversified all non-core Ruby Tuesday assets, either by liquidation or by straight-out closure. Its Mexican food chain, Lime Fresh, was sold for $6 million, barely 1/4th what the corporation paid for it two years ago. In the company's Asset Rationalization Plan, stores with a negative net present value will be closed. In August 2016, Ruby Tuesday announced that this plan would result in the closure of 95 underperforming locations. Interestingly, the effect of closing these 95 stores meant that the company completely pulled operations out of Idaho, Kansas, Oregon and Utah. The company significantly reduced operations in Texas, New York, Minnesota, Illinois, Colorado and Arkansas. Reducing the number of markets Ruby Tuesday competes in will most likely decrease the amount of "other restaurant operating costs" and SGA.

In an attempt to attract new customers, Ruby Tuesday completely revamped the Garden Bar and added new menu items. While management is extremely excited about the new Garden Bar, a scan of current social media comments reveals that the customer jury is still out. The vast majority of the negative comments are complaints about the discontinuation of certain salad dressing options or other options. Not only does management expect the Garden Bar to increase traffic, it is also slightly more "cost effective." (latest 10q) The new menu "simplified recipes and procedures for our kitchen," (latest 10q) while raising prices substantially across the board. In the short term this will undoubtedly help earnings, but long term this will eventually drive away the lower income customers.

The biggest issue with Ruby Tuesday is that management does not understand the dire situation it is in. With losses adding up to nearly $100 million in the last 12 months, Ruby Tuesday will burn through the remaining amount of properties it owns within the next 3-5 years to pay for its heavy losses. The good news is that executive departures are on the rise. James Buettgen, Ruby Tuesday's CEO of the last four years, resigned in September, following the resignation of their CFO last April. Ruby Tuesday's new interim CEO is F. Lane Cardwell Jr., a widely respected industry veteran. Previously Cardwell was the CEO of Boston Market (owned by Sun Capital Partners, a private equity firm specializing in restaurants), and the CEO of P. F. Changs (until it was sold to Centerbridge Partners, also a private equity firm that specializes in restaurants.) It seems likely that management picked F. Lane Cardwell Jr. in an attempt to draw interest in a buyout.

Ruby Tuesday is in immediate danger. Management's reaction to nearly 4 years of massive net losses is to try, yet again, rolling out a modernization of Ruby Tuesday locations complete with a new salad bar and menu. Each member of Ruby Tuesday's management and board is a long time industry and Ruby

Tuesday veteran. This is a serious concern, as not only are they most likely blinded their own experience, but they have also lost touch with their target market. This is a group of 60-year old males targeting the "25-40 year old women with young families" market.

The Fresh Start Initiative is similar to an initiative between 2007 and 2009, where Ruby Tuesday spent nearly $100 million renovating stores, training staff, and updating the menu. At $110,000 per store, the investment seemed to only postpone the inevitable for Ruby Tuesday. They seemed to be successful in plugging a large hole in same store sales, but failed to turn the investment into profitability. Seven years later, same store sales are plummeting again and the chain is again looking to reinvent the brand. Will the new Garden Bar be successful enough to return growth where a $100,000 investment couldn't? Will closing unprofitable stores help the entire chain? Or will the reinvestment be just as unsuccessful and wasteful of shareholder capital?

Management needs to take this issue more seriously than ever. When compared to the rest of the industry, Ruby Tuesday has an inferior product, lower margins, and lower same store sales. Management's reaction to this has been unimaginative and repetitive. They seem to think that the current situation is simply a storm that they will likely pilot through. They view this situation as no different from similar periods before. Yet in reality this is arguably the last one for the chain. Management needs to wake up and take drastic measures for the chain to turn around.

The only positive aspect of Ruby Tuesday Inc. is its vast real estate portfolio. This will be discussed extensively in the investment thesis part of this paper. Buy Ruby Tuesday the REIT, get a failing cash flow negative business for free.

## Investment Thesis: REIT Spin Off

A large percentage of the value of Ruby Tuesday lies in the physical properties that Ruby Tuesday has purchased over the years. Each Ruby Tuesday operation is classified as either an owned building and land operation, an owned building leased land operation, or a leased land and buildings operation. In the past, approximately every two years Ruby Tuesday has closed stores that had a negative net present value.

The latest closings occurred in August 2016 when Ruby Tuesday announced its Asset Rationalization Project (ARP). This identified 95 stores with a negative net present value that would be closed. "Of the restaurants expected to close, approximately two-thirds are operated on leased properties and approximately one-third are owned." (2016 10k) Using the data in the ARP and the latest expected income for the sale of these properties, it is possible to estimate what a REIT containing solely Ruby Tuesday properties would be worth.

The value of a store in a REIT would be the market value of the sale minus the costs to close the store. The costs to close stores are outlined in "Closures and Impairments, net" from the latest 10-Q, and also shown in the chart below. Q4 2016 was affected by a large $30m Closure and Impairment fee, due to the Asset Rationalization Program and the closure of 5 additional stores. Since Ruby Tuesday has many more operations that are owned rather than leased, the costs of closing the stores must be separated into these two groups. The exhibit below shows the Closure and Impairment fees separated for each type of Ruby Tuesday location being closed.

Figure 1: Costs associated with closing Ruby Tuesday Locations

| | 13 weeks ending 8/30/16 | Owned Land and Buildings | Leased buildings and land |
|---|---|---|---|
| **Property impairments** | $ 6,580 | $ 2,237 | $ 4,343 |
| **Closed restaurant lease reserves** | $ 17,728 | $ 0 | $ 17,728 |
| **Inventory write-off** | $ 2,754 | $ 936 | $ 1,818 |
| **Severance benefits** | $ 1,760 | $ 598 | $ 1,162 |
| **Other closing expense** | $ 1,427 | $ 714 | $ 714 |
| **Closures and impairments, net** | $ 30,249 | 14.83% | 85.17% |

Roughly 15% of Closure and Impairments fees are related to closing locations that are owned by Ruby Tuesdays. Using the data from the costs associated with the Asset Rationalization Project, we are now able to better understand the cashflows associated with closing each Ruby Tuesday location, based on type of ownership. In Ruby Tuesday's 2017 Q2 earnings call, they noted that the sale of these properties would garner between $45-50m.

Figure 2: Income/cost attributable with closing Ruby Tuesday Locations

| | Owned Land and Buildings | Leased buildings and land |
|---|---|---|
| Number of stores | 34 | 66 |
| Impairments | $ 4,485,460 | $ 25,763,540 |
| Impairments per store | $ (131,925) | $ (390,357) |
| Average Sale Price per Store | $ 1,397,059 | $ 0 |
| Net Income per Store Closure Type | $ 1,265,134 | $ (390,357) |

Plugging in the value of the future cash flows per store location gives a better estimate of what all stores are worth. Since we have no data on locations that were owned building leased land, it is assumed that their value is two-thirds the value of an "owned land and building" operation and one-third the value of a "leased building and land operations". This is a very conservative estimate considering that a thumb rule for commercial property valuations is that the building is worth 4 times the property value.

Below is a revised estimate of future closing values of stores still operated by Ruby Tuesday. Notably, in the majority of its downsizes, Ruby Tuesday has chosen to close leased building and land operations, leaving them with very few remaining leased locations.

Figure 3: Market Value of Ruby Tuesday Properties - cost

| | May 2016 | Number of stores closed in AR | Stores after AR closurer | Latest Estimate | Latest Estimate Market Value |
|---|---|---|---|---|---|
| Own Land and buildings | 303 | 32 | 271 | 269 | $339,740,014 |
| Owned buildings, non cancelable lease | 252 | | 252 | 250 | $ 178,121,325 |
| Leases buildings and land | 91 | 63 | 28 | 28 | $ (10,830,803) |
| Total | 646 | 95 | 551 | 546 | $ 507,030,536 |

Ruby Tuesday management has stated that the proceeds from asset-lease back sales will be returned to the business by paying off long term debt, in an attempt to deleverage. While management would most likely spin down negative performing locations at different times, we will be calculating the value of a REIT spinoff, where shareholders would receive shares after a fair portion of long term Ruby Tuesday debt is paid off. While the SEC has recently moved to limit REIT spinoffs, it is highly likely that a Ruby Tuesday REIT would be approved. Darden, a very similar competitor, was approved for a REIT spinoff after the new SEC rules were in place.

The best way to value a REIT spinoff would be through a comparable analysis. Ruby Tuesday's REIT's comparables are combined with a summary of key metrics below.

Figure 4: Ruby Tuesday REIT Comparables

| | EV to EBITDA | EBITDA to Debt | Interest to Total Debt | Depreciation to Real Estate Value | Rental Income to Real Estate Value | Cost of Capital | Price to book | Price to Property | Price to Earnings |
|---|---|---|---|---|---|---|---|---|---|
| **Four Corners Property Trust** | 17.53 | 4.17 | 3.80% | 2.50% | 13.00% | 8.01% | 2.91 | 1.53 | 21.8 |
| **National Real Properties** | 21.08 | 5.09 | 4.20% | 2.40% | 8.00% | 5.89% | 1.73 | 1.08 | 31.4 |
| **Spirit Realty capital** | 16.98 | 7.24 | 6.00% | 3.80% | 9.00% | 5.99% | 1.33 | 0.73 | 43.6 |
| **Realty Income** | 22.56 | 5.72 | 4.40% | 3.60% | 9.00% | 5.76% | 2.23 | 1.34 | 53.1 |
| **Store Capital** | 22.69 | 8.53 | 3.80% | 1.90% | 6.00% | 5.93% | 1.50 | 0.79 | 43.2 |
| **Average** | 20.17 | 6.15 | 4.50% | 2.80% | 9.10% | 6.32% | 1.94 | 1.09 | 38.6 |
| **Weighted Average** | 19.81 | 5.47 | 4.40% | 3.00% | 10.00% | 6.49% | 2.07 | 1.17 | 34.3 |

Using the comparables above, and the $507M worth of property, we can accurately create a model of a Ruby Tuesday REIT. Finally, using a multiple and discounted cash flow approach, we can estimate the value of a Ruby Tuesday REIT.

Figure 5: Ruby Tuesday REIT Pro Forma Income Statement, & Valuation

| | Feb-17 | Feb-18 | Feb-19 | Feb-20 | Feb-21 |
|---|---|---|---|---|---|
| **Revenue** | $ 49 | $ 51 | $ 53 | $ 55 | $ 57 |
| **Operating Costs & CGS** | $ 20 | $ 21 | $ 22 | $ 23 | $ 24 |
| **D&A Expense** | $ 14 | $ 14 | $ 14 | $ 14 | $ 14 |
| **EBIT** | $ 29 | $ 30 | $ 31 | $ 32 | $ 33 |
| **Interest Expense** | $ 10 | $ 10 | $ 10 | $ 10 | $ 10 |
| **Tax Expense** | $ 7 | $ 8 | $ 8 | $ 9 | $ 9 |
| **Net Income** | $ 11 | $ 12 | $ 13 | $ 13 | $ 14 |
| **EBITDA** | $ 42 | $ 43 | $ 44 | $ 46 | $ 47 |

| | Value of Ruby Tuesday REIT |
|---|---|
| **EV/EBITDA** | $ 834,814,763 |
| **Discounted Cash Flow** | $ 1,079,152,334 |
| **Average** | $ 956,983,549 |

A Ruby Tuesday REIT, would be valued at $956 million. But before the REIT can be created, Ruby Tuesday must pay off its senior unsecured notes, which are valued at $212 million, because these notes have a covenant restricting a significant asset sale. These notes will be callable on March 6, 2017, at a price of $220m. The current market price of these notes are $97.1m, meaning there is market value of $206m. For simplification purposes, we will assume Ruby Tuesday can purchase one third of its outstanding debt on the market and two thirds through calling it. This leads to a cost of debt $215m. Subtracting this from the $956 million of the Enterprise Value of the REIT, the equity value of the REIT would be worth $741 million or $12.24 per share, which is nearly 6.44 times what the Ruby Tuesday Inc. current price is today. But to unlock that value, Ruby Tuesday would need to accept the demise of the Ruby Tuesday restaurant.

## Legality

One Harvard Business School case study on the Marriott split-up defines the test which determines if an asset spinoff is of fraudulent nature.

*According to section 548(a)(2) of the Bankruptcy Code, constructive fraud could be established when the debtor:*

1. *received less than reasonably equivalent value for the property transferred; and*
2. *either*
    - *a) was insolvent or became insolvent as a result of the transfer,*
    - *b) retained unreasonably small capital after the transfer, or*
    - *c) made the transfer with the intent or belief that it would incur debts beyond its ability to pay.* [5]

The same case notes that research printed in the WSJ has shown that LBO transactions that eventually sent a company to default on their liabilities on purpose usually settled out of court for an average of 10 cents on the dollar.[6]

By sending Ruby Tuesday into bankruptcy, the only long term liability that would not be paid off by this investment thesis is a $100 million deferred pension plan, which is usually treated as debt. The legality of doing that is not clear, but regardless, that pension fund will be non-existent in 5 years if determinations at Ruby Tuesday continue. One could argue that the market value of this deferred pension plan is much lower then its book value, and a possible settlement could most likely be reached.

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5 Harvard Business School, “Marriott (A)”

6 Jack Friedman, “LBO Lawsuits Don’t Pick Deep Pockets,” *The Wall Street Journal*, January 27, 1993.