The Bear Facts

Report Date:
May 22, 2017

Badger Consultants, LLC
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Red Robbin Gourmet Burgers.
RRGB $72.95 – NasdaqGS
Update: 2017 First Quarter Results

Recommendation: Sell Short

Reasons For Short Sale Recommendation

- Revenue up 4.1% to $418.6 million, +0.4% better than expectations.
- **EPS down 13.6%** from $1.03 to $0.89, but "beat the number" $0.50.
- **Net income down 18.3%**, from $14.2 million to $11.6 million.
- **"Adjusted" EBITDA down 6.3%**, from $48.9 million to $45.8 million.
- Restaurant level **operating profit down 180 bps**, from 22.7% to 20.7%.
- **Average weekly sales**, company owned, **down 1.2%**.
- **Labor cost up 9.4%**, more than double revenue increase.
- **Gross margin down 137 bps**, from 42.6% to 44.0%.
- **Income from operations down 13.5%**, from $20.175 million to $17.458 million.
- Opened 6 stores, closed 2 stores.
- Tax rate 20.1% vs 23.3%.
- **Same store sales down 1.2%**
- **Guest count down 1.7%**, seventh quarter in a row of negative counts!
- Increased EPS guidance by 10 cents, $2.80 to $3.10.
- Plans to open 17 and close 9 stores in 2017, 8 net new stores, +1.5%.

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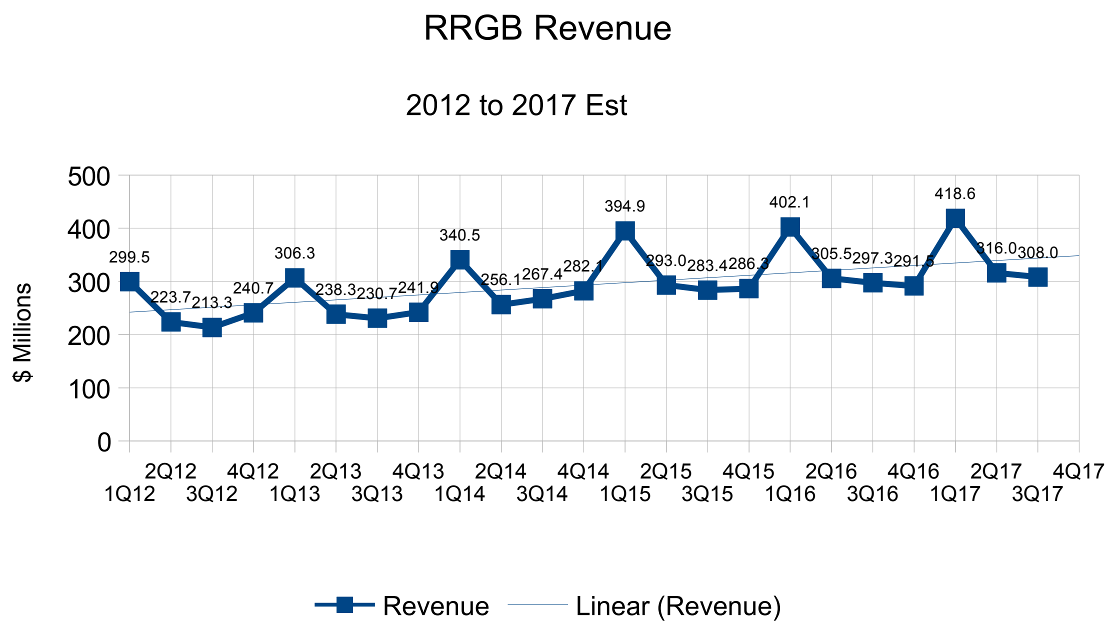

The first quarter is always the strongest for RRGB. The 2017 first quarter revenue was up 4.1% to $418.6 million. **Management is guiding 2017 revenue to be up between 6 percent to 8 percent**. This is the same thing they said last year, that revenue would be up 6% to 8%. **Actual revenue growth in 2016 was up only 3 percen**t from $$1.257 billion to $1.296 billion.

RRGB had 551 total stores at the beginning of 2017, **they are planning on opening 17 and closing 9 for the 2017 year. That is a net gain of 8 new stores. 8 new stores/551 stores = 1.45% growth.** They opened 6 new stores during the quarter and closed 2, so they are going to open about 11 more during the remaining three quarters, but they are going to close about 7 more, so that is only a **net gain of 4 new stores for the remainder of the year, 0.7%.** 1.45% growth in new stores plus negative same store sales equals zero growth. Management is now guiding to 0.5% to 1.5% same store sales, so on a best case basis, would equal 3 percent. **Guest counts have been negative for almost 2 years,** so this could be a stretch.

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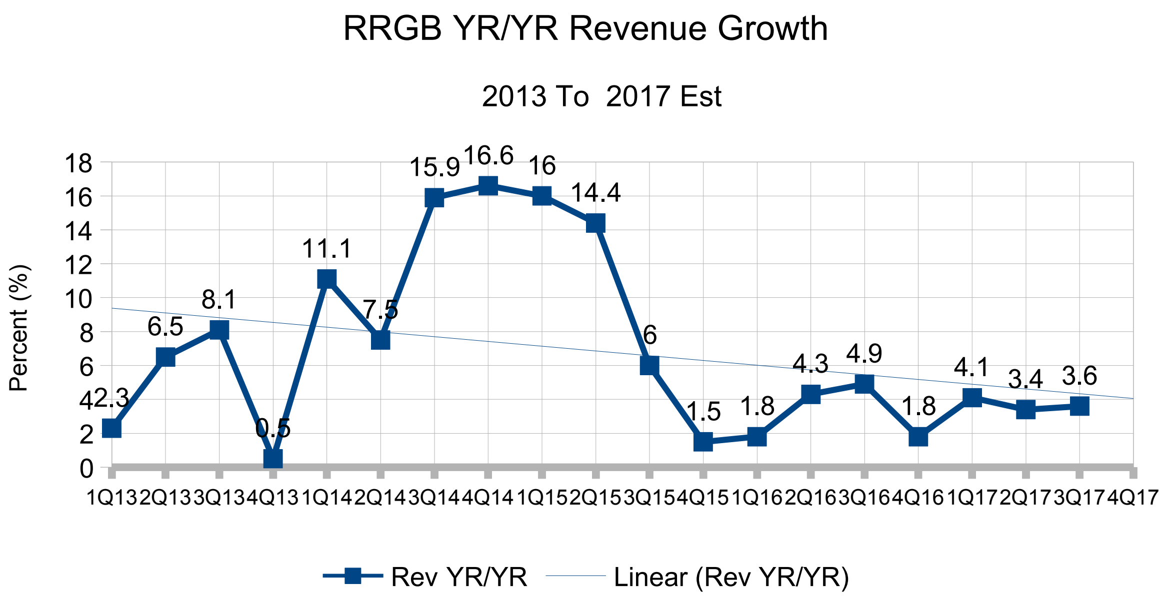

2017 first quarter revenue growth was up 4.1%, but same store sales were negative 1.2%, negative 1.7% in guest count, offset by a positive 0.5% in ASP. So, **all the growth in revenue is coming from new store openings**. Only opening 8 net new stores in 2017 is 1.45% growth.

In 2016 the company opened 13 net new stores, from 538 stores to 551stores or growth of 2.4 percent. What was RRGB's revenue growth in 2016? 3 percent.

In 2017 they are opening only 8 net new stores, less than the 13 they opened last year, that's almost 40 percent less store growth than last year, but revenue growth is going to more than double, from 3 percent to between 6 to 8 percent?

If store growth in 2017 is going to be 1.45%, same store sales would have to be positive 4.5% to 6.55% to hit revenue growth of 6 to 8 percent. But management is guiding same store sales to be only 0.5% to 1.5%.

2017 second quarter revenue growth is estimated to be 3.4%, down from 4.3%. the year before.

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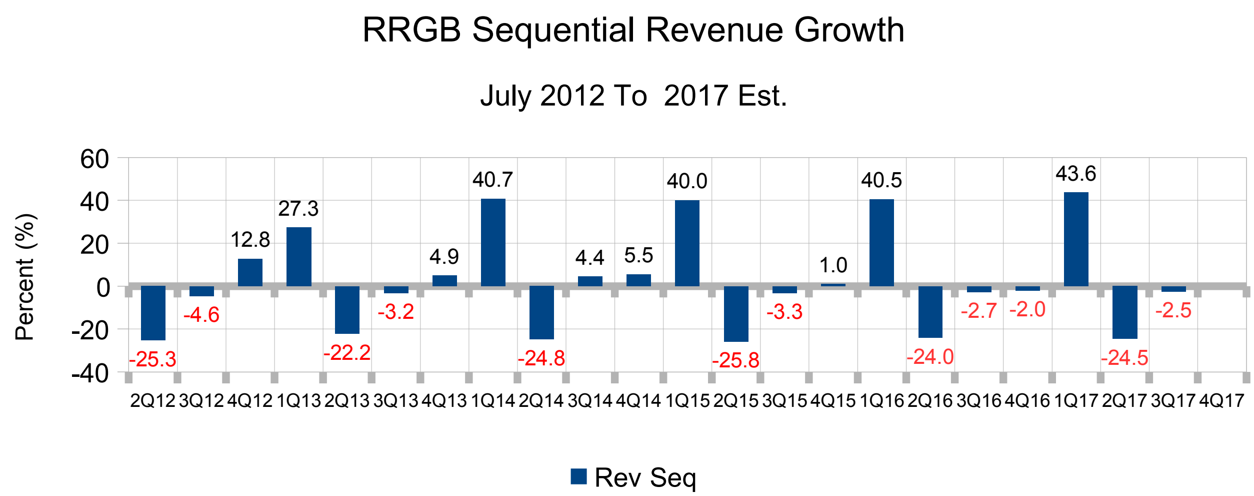
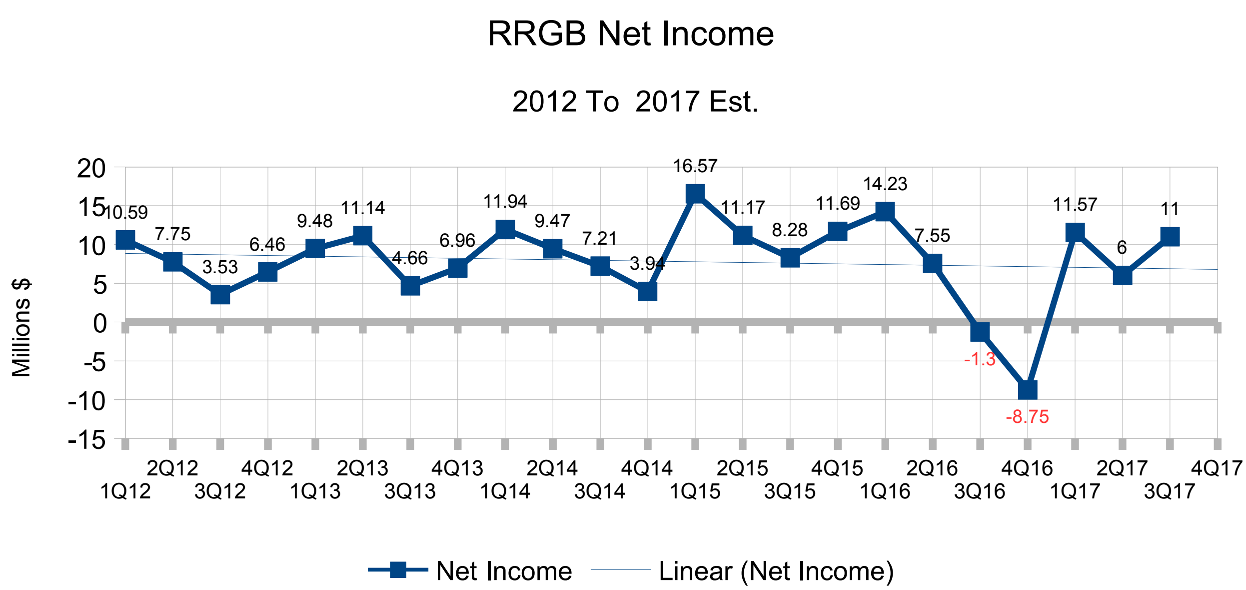


2017 1st quarter sequential revenue growth was slightly better than previous year. Next quarter not so much.



Net income was down 18.3% in the 2017 first quarter, no higher than four years earlier, despite having 79 more stores. The 2017 second quarter will be worse.

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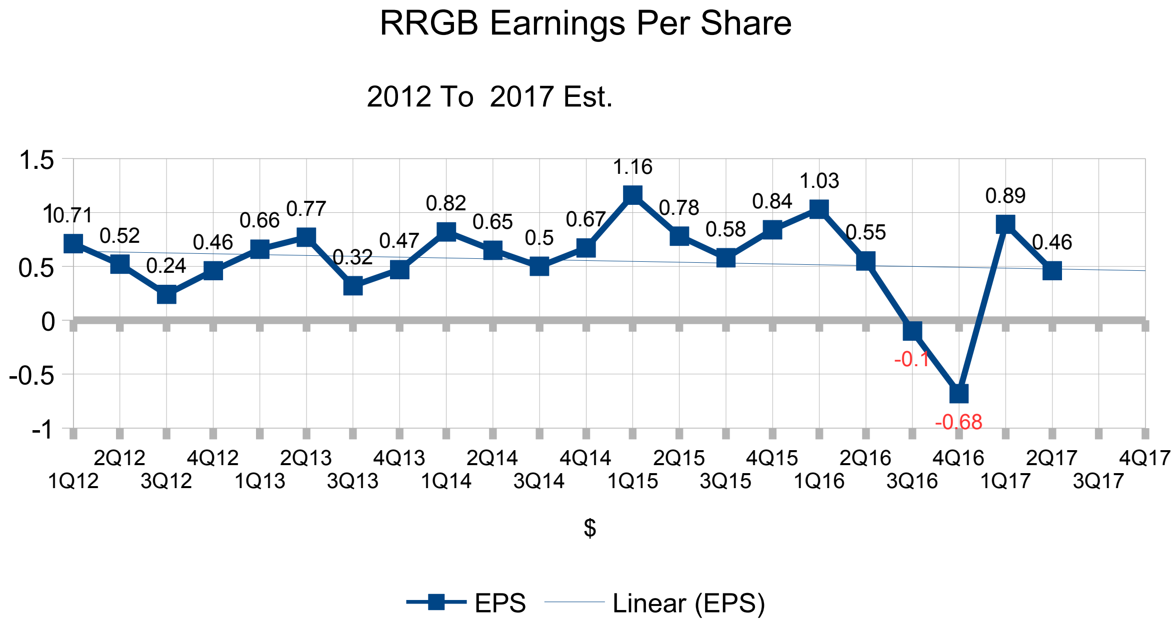

Earnings per share for the 2017 first quarter were better than expectations of $0.50, so the stock went crazy on the "beat the number" game. But the earnings were down 13.6 percent from a year earlier. Does anyone actually look at what the number is, not just better than expected? **The first quarter is usually one of their stronger quarters, and it was down 13.6 percent from a year ago**. With more stores closing, there will be more charges, similar to the third quarter last year when they closed 9 stores. **With 4.1 percent revenue growth, earnings declined 13.6 percent.** It is hard to figure out why investors would be willing to pay 25 times earnings of $3 for these guys for three percent growth?

RRGB earned $3.36 in 2015, they are going to earn less than that this year. At the high end of the earnings guidance of $3.10, thats almost 8 percent below 2015. The low end is 17 percent below 2015. A multiple of 15 to 20 is much more reasonable, which translates to $42 to $60. And that assumes same store sales and guest count turn positive, which they have not for two years. **The 2017 second quarter EPS estimate of $0.46 is lower than the 2012 second quarters $0.52, five years earlier, with 100 more stores and 2 million less shares outstanding! This is a terrible business to invest in.**

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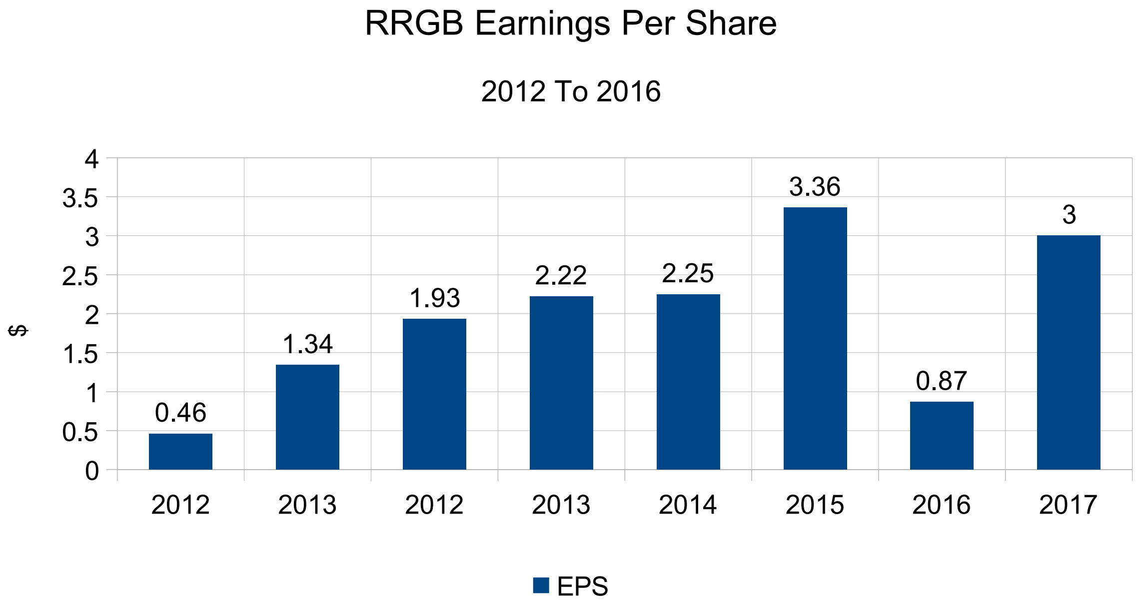

Management is guiding to 2017 EPS of between $2.80 to $3.10. Best case this is below 2015. **Management does not have a good track record of forecasting revenue and earnings**. We believe EPS will be below $3, depending on the number of store closing and guest counts.

In 2016, management guided revenue to be up between 6 to 8 percent, actual revenue growth in 2016 was only 3 percent, 50 to 60 percent less than forecast.

On November 2, 2016, RRGB gave 2016 fourth quarter guidance of **revenue growth of between 4 to 6 percent** and **Same Store Sales growth of between negative 1.5% to negative 3.5%**. This forecast was given with one third of the quarter already in the books.

RRGB then in Jan 2017 pre-announced that sales in the 2016 fourth quarter would be $290.8 million. They did not announce that this would be **revenue growth of just 1.6 percent**. They also announced that **Same Store Sales would be negative 4.5 percent along with a negative guest count of 2.9 percent.**

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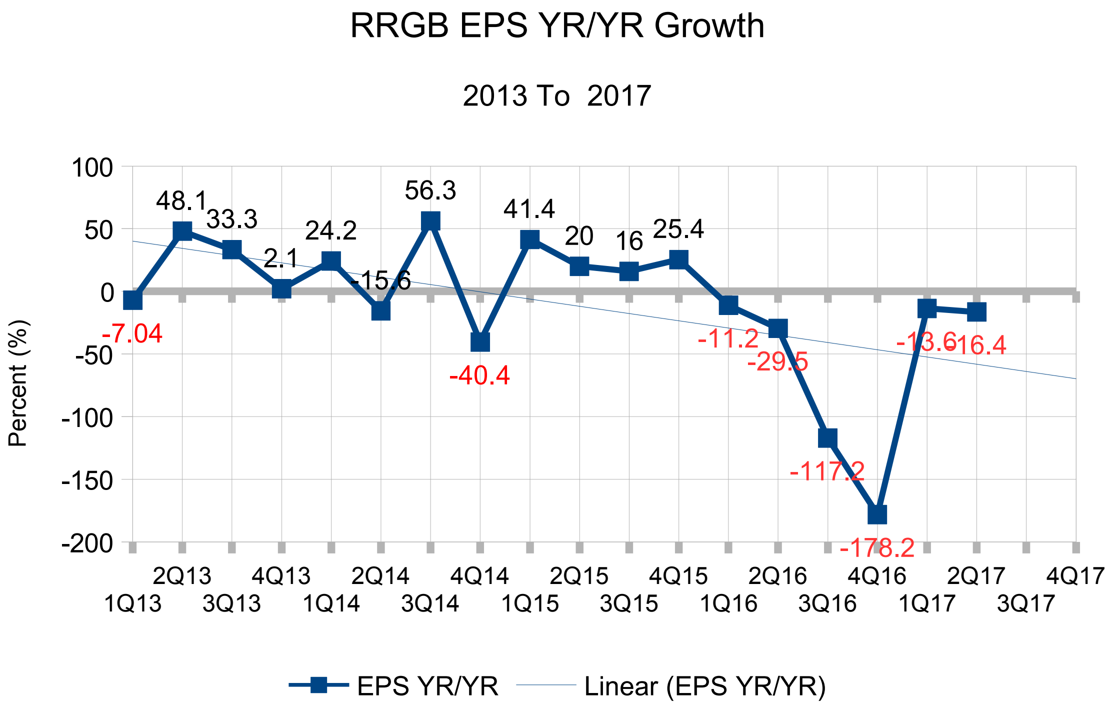

Earnings growth fell off a cliff, so now it is somewhat stabilizing, but still down significantly. This does not warrant a 25 multiple. If they can get earnings growth back to zero, that would be an accomplishment, not a good accomplishment, but...

Management is guiding to 2017 EPS of between $2.80 to $3.10. If we use $3 as the number, management is saying that **45% of EPS will be in the first half and 55% will be in the back half of 2017.** Forty five percent of $3 is $1.35, so subtract out the 89 cents from the first quarter of 2017 and **you get EPS $0.46** for the second quarter of 2017 **versus $0.55 in 2016**. That is down 16.4 percent, worse than the -13.6 percent in the first quarter. **If we use $2.90 as the "number" for 2017, that would translate to $0.42 for the second quarter, which would be 24 percent below 2016**. The consensus estimate for the year 2017 is $2.88. **The consensus estimate for the 2017 second quarter is $0.53. EPS miss next quarter?**

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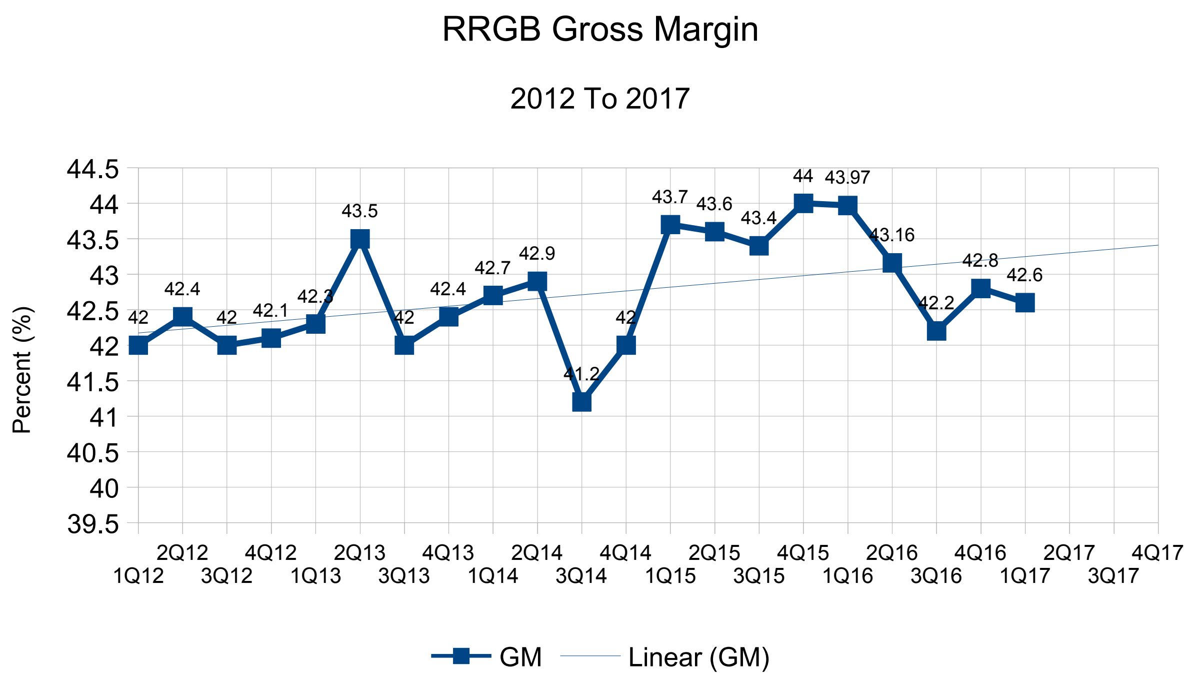

Gross margin has been trending down for two years. In the 2017 first quarter, gross margin declined 137 basis points from 44.0 to 42.6%. Labor costs have been climbing faster than revenue growth. In the 2017 first quarter, **labor cost rose 9.4%** from $132.9 million to $145.5 million, **more than double the 4.1% increase in revenue.**

"The 2016 class of new restaurant openings, generated revenues that were about $2.5 million below our expectations." This could mean that they are getting "B" locations, because they are not performing as well.

"**Cost of sales improved 40 basis points to 22.9%, driven primarily by deflation in both poultry and ground beef and improved waste management. However, recent sharp increases in beef prices will likely increase our food costs approximately $1 million more than originally projected in Q2.** So, their beef and chicken prices declined, yet their gross margin still declined because of the 9.4% increase in labor costs and now beef prices are surging, so look for continued declines in gross margin, which makes attaining earnings estimates harder.

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"General and administrative expense improved 60 basis points or **$1.1 million** to 7.4%. Most of the year-over-year favorability in G&A was due to timing and **will reverse in future quarters**." This too will make hitting earnings goals harder.

"Our first quarter **tax rate was 20.1%**, at the lower end of our annual expectation and **320 basis points lower than a year ago.** And earnings per diluted share were $0.89 as compared to adjusted EPS of $1.27 in the first quarter of 2016 or a **decline of 29.9%"**. On an apples to apples tax rate, 2017 first quarter EPS would have been $0.86.

"We invested 25 -- $24.5 million in CapEx in the first quarter, primarily related to new restaurant openings, restaurant maintenance capital, investment and technology projects and remodels. As we outlined in our annual guidance, the **company did not repurchase any shares in the quarter and does not expect to do so in 2017."** They only have $22 million in cash, not enough to buy back stock anymore. **Shares outstanding** declined 830,000 compared to 2016, BUT **increased 84,000 sequentially. The seven percent boost to earnings from buying back stock every year is soon to be over.**
We ended the quarter with $22.2 million in cash and cash equivalents, up about $10 million versus where we ended 2016, and we finished the quarter with a lease-adjusted leverage ratio of 4.23x.

"Lastly, **we now project our 2017 earnings per diluted share to range from $2.80 to $3.10.** This represents growth of flat to up 11% versus adjusted EPS of a year ago. As we outlined in February, with the lapping of our value emphasis not coming until the third quarter and the benefits of on-demand skewed more to the back half of the year, **we expect to earn approximately 45% of our 2017 projected EPS in the first half of the year and 55% in the back half of the year.** So, if we assume that EPS next quarter will be only 46 cents and new store growth is 1.45% and same store sales improve to zero, they will not make their earnings estimates.

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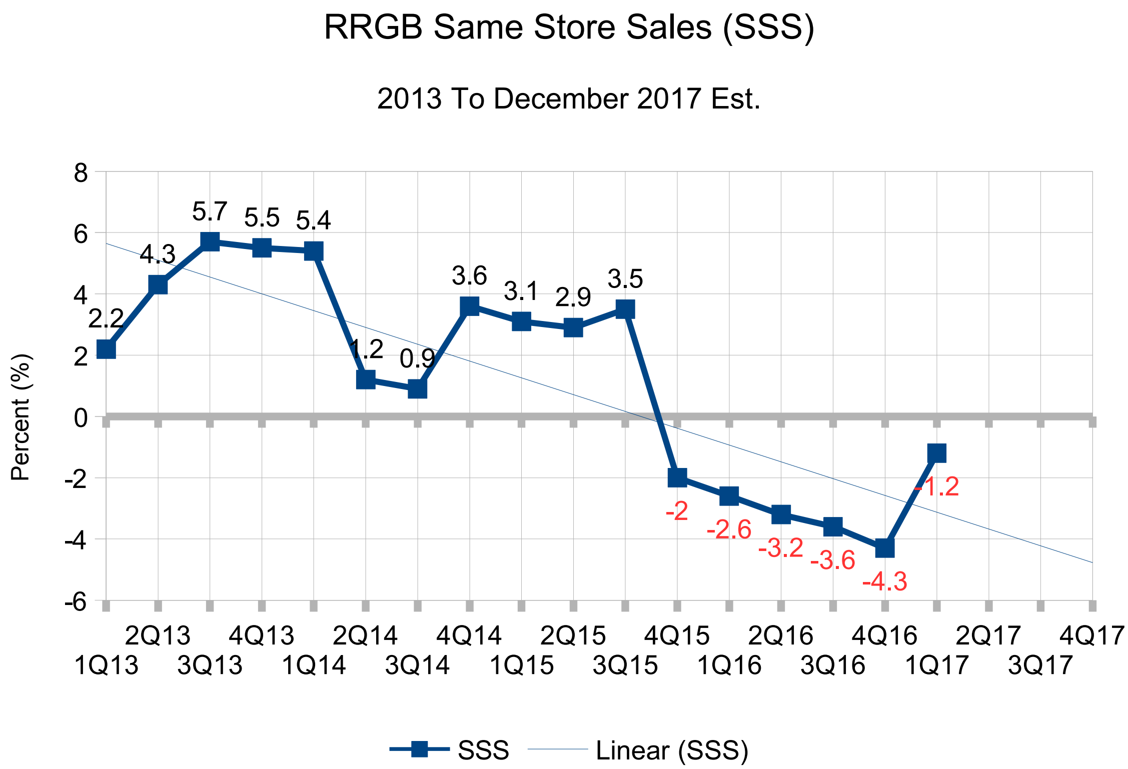

Same store sales were -1.2 percent in the 2017 first quarter. This was an improvement from one year ago when SSS was down 2.6 percent. However, IT **IS STILL NEGATIVE**. The sixth quarter in a row of negative same store sales, despite all the stores being remodeled, despite lower prices, despite higher customer scores, etc... It also is a negative number on top of a negative number.

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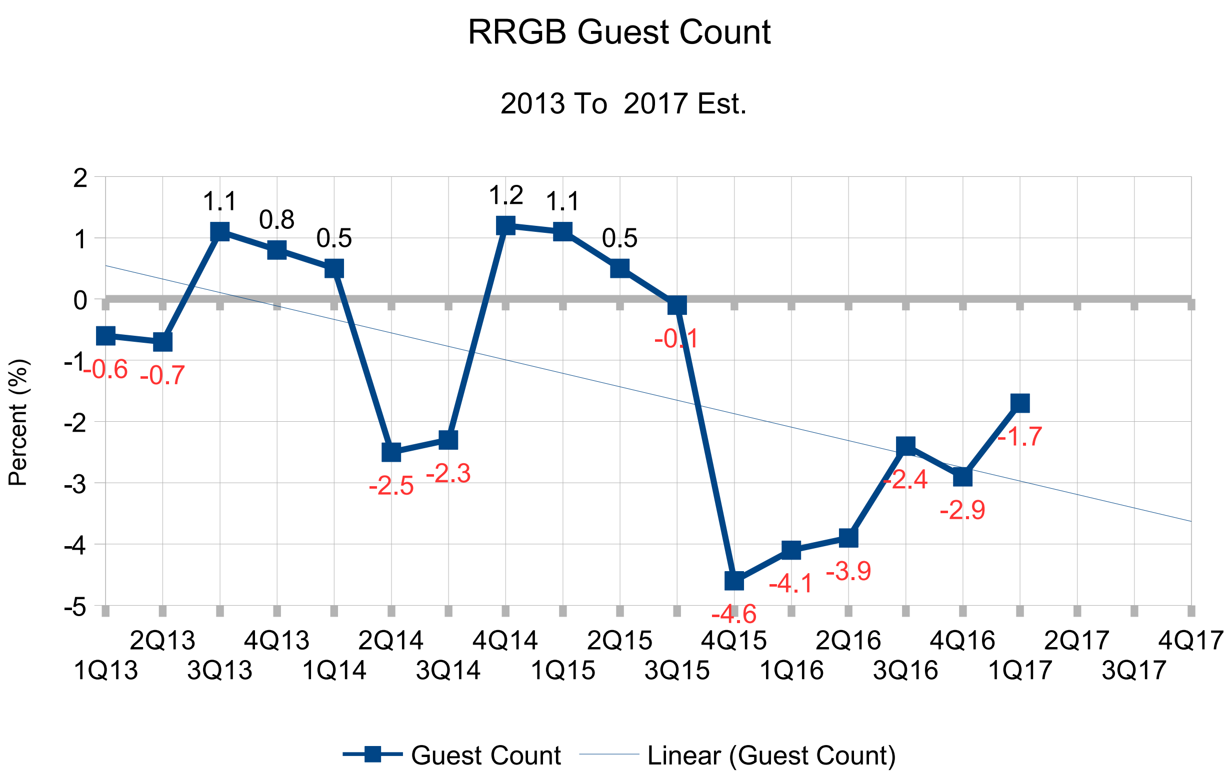

Guest count was negative 1.7 percent in the 2017 first quarter. This too was an improvement versus the negative 4.1 percent a year ago, but it is still negative and **has been negative for seven straight quarters, almost two years!**. Why is it still negative after remodeling all the stores? Why is it still negative after lowering prices? Why is it still negative after improved customer scores?

Worse, it is a negative number on top of a negative number. Customers coming through the door is the single most important metric. This number has never been good for the past five years.

The company used to open 16-20 stores a year, (5 percent growth), plus same store sales of 3 to 5 percent, plus buying back stock equals EPS growth of 15 to 20 percent. Now, they open 8 stores a year,(1.5% growth), minus same store sales of negative 2 percent, plus no more buying back stock equals ZERO EPS growth!

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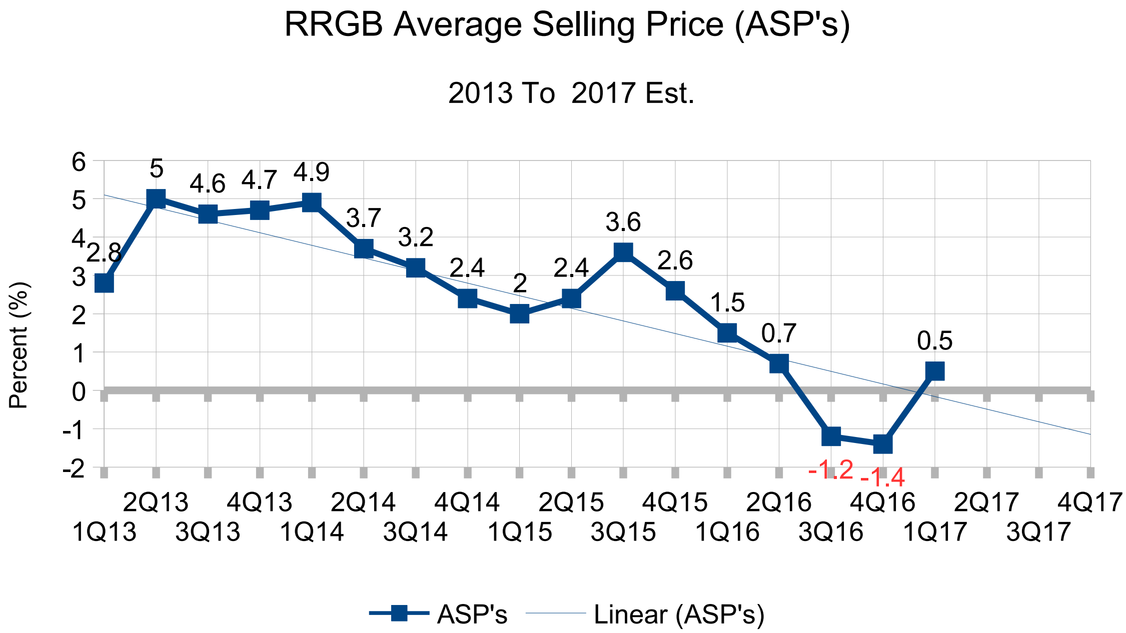

ASP ticked back up into positive territory, which is good, but guest count is far more important. RRGB raised prices 1.9 percent.

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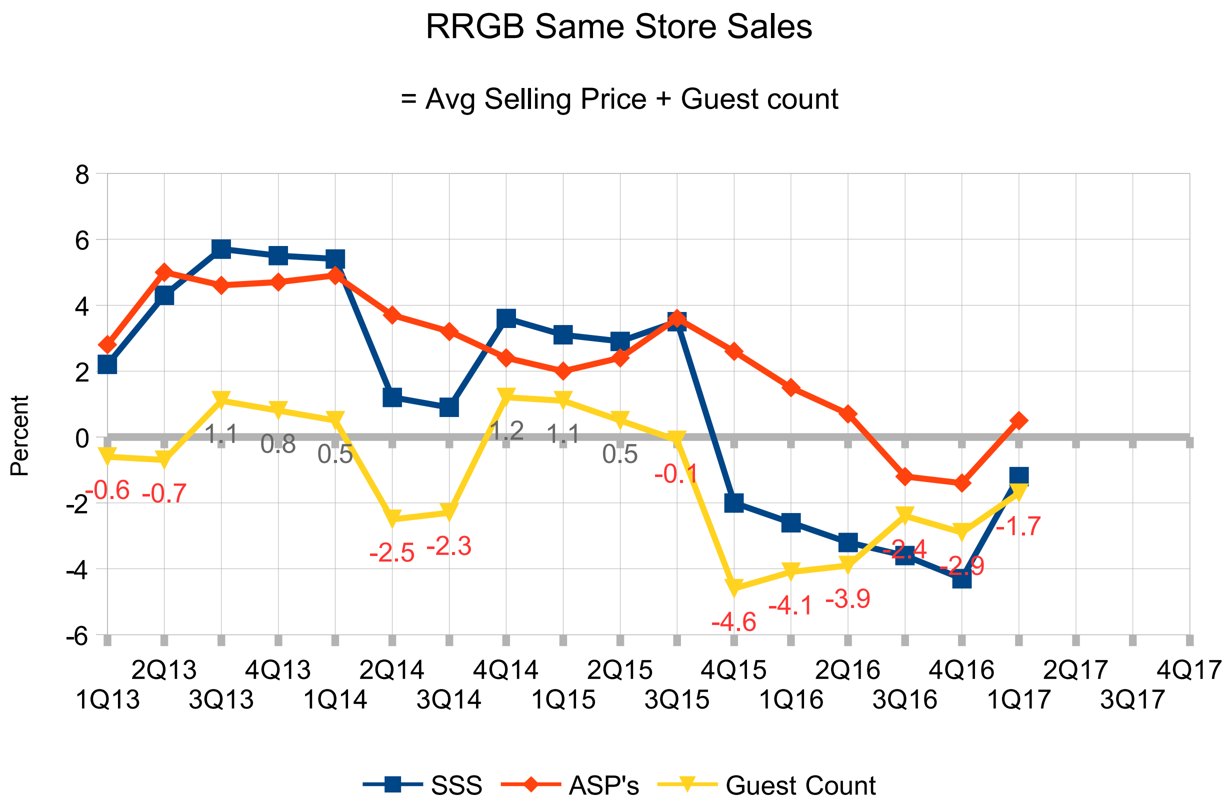

Bulls are going to say that this is getting better, **but in reality its getting worse just at a smaller rate.** For example, at the end of 2015, if a store owner had 100 customers per day, by the end of the 2016 first quarter, he would now have 95.9 customers per day. At the end of the 2017 first quarter he would now have 94.2 customers per day. **He is clearly WORSE off in 2017 than the year before and 6 percent worse off than two years earlier.**

The fact that RRGB had to close 15 stores in 2016 and is going to close 9 more, at least, in 2017, tells you that things are not great with this franchise. The fact that the stores opened in 2016 are underperforming is a bad sign as well. We have been bearish on these types of restaurants because of the financial situation of their customers. They just don't have a ton of disposable income. Health insurance premiums have been rising sharply across the country and they are poised to rise sharply again in 2018 if the republicans don't fix/repeal Obamacare. If health premiums rise again, look for RRGB same store sales to

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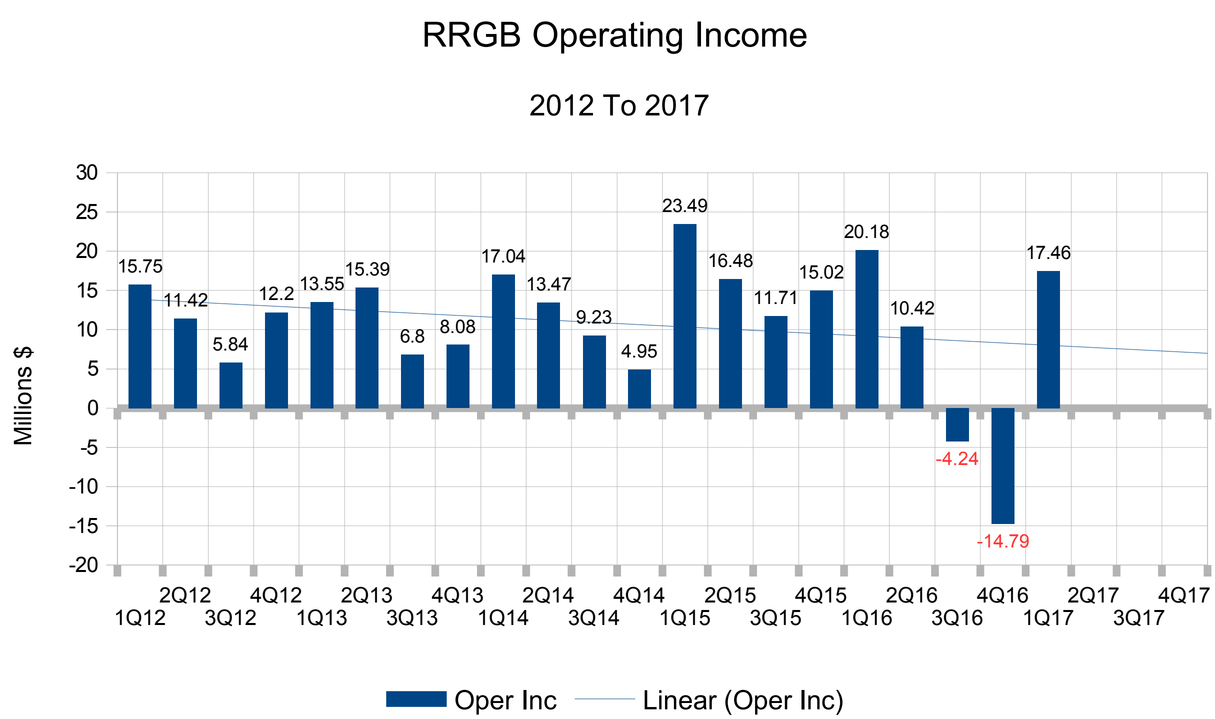
resume their downward trajectory. Their guest count numbers have been negative for almost two years. If that was to continue for another year, RRGB will be in serious trouble. A ten percent decline in customers can be fatal to a restaurant.



Operating income is the same as it was in the first quarter of 2014, three years ago.

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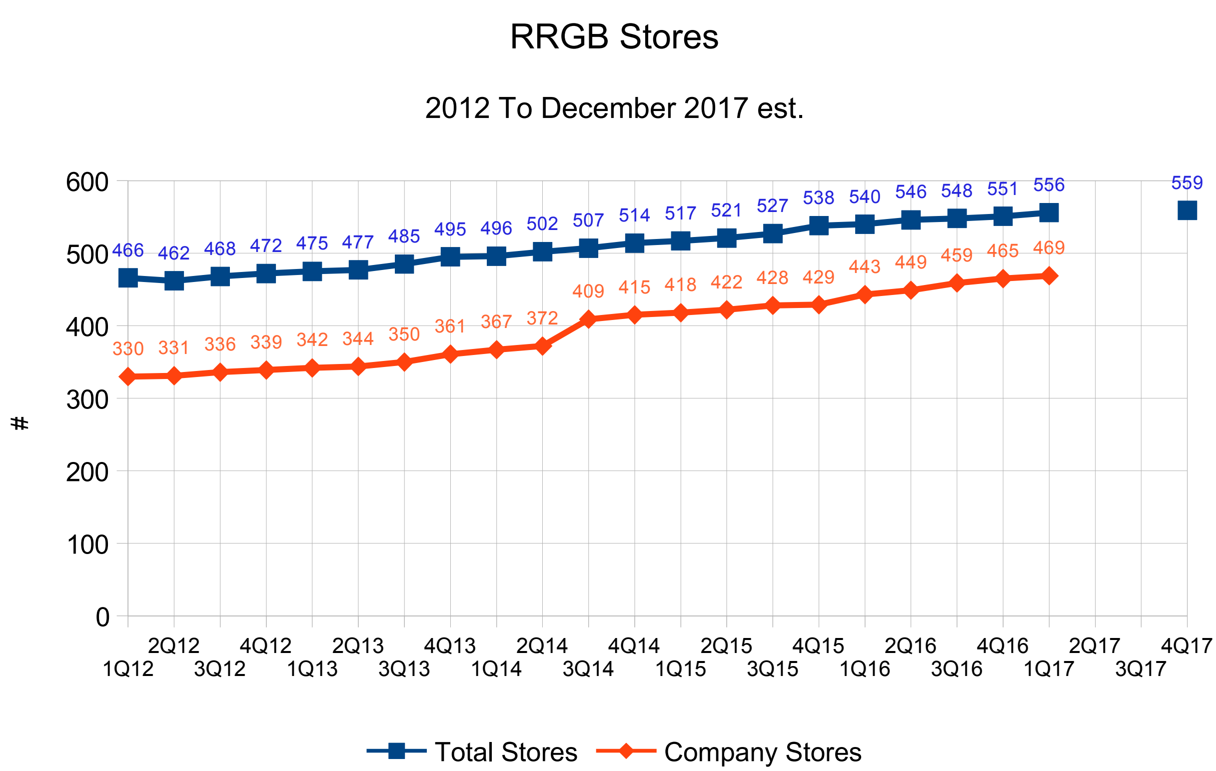
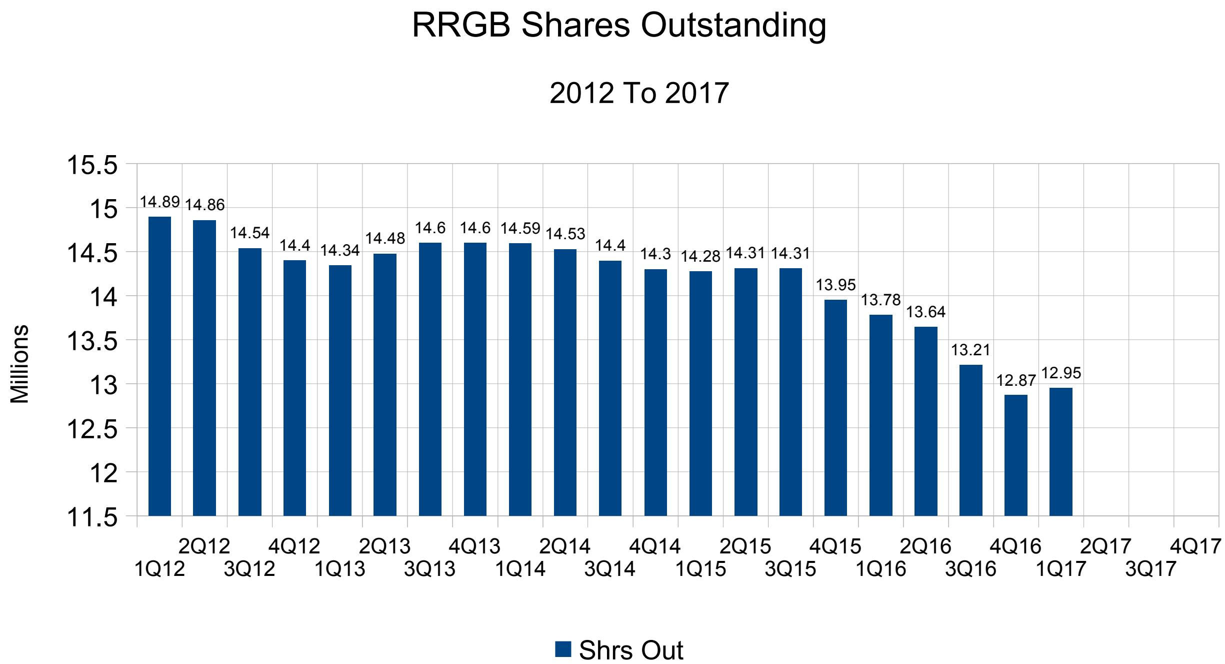


You can see that the growth in new stores is slowing quickly. RRGB ended 2016 with 551 total stores, they will end 2017 with about 559, a net gain of 8 stores, or 1.45%. This assumes that they open 17 and close 9. We believe that more than nine stores could close in 2017.



RRGB stopped buying back stock in the 2017 first quarter. There were 830,000 fewer shares outstanding compared to the first quarter of 2016, but 83,000 more sequentially. The days of buying back stock to pump up earnings by 5 to 7 percent are now over, and will start to reverse a little. RRGB is down to $22 million in cash.

In the 2017 first quarter, with the lower tax rate and lower shares outstanding, added 9 cents to the $0.89 in earnings, both of those are going away. Lower G&A expense added 7 cents to the quarter, that will be reversed in the 2017 second quarter.

So, while the $0.89 was much better than the estimate of $0.50, it was still down 13.6 percent. Next quarter will be worse, down 16 to 24 percent. The best you can say about this company is that it is getting worse more slowly. They raised prices 1.9 percent, which has always hurt their guest count down the road. The stock had a 30 percent short interest, so everybody panicked in the short term. The stock price has now factored in a complete recovery, even though guest counts and same store sales are still negative. Our price target remains $45-$50.

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RED ROBIN GOURMET BURGERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Sixteen Weeks Ended	
	April 16, 2017	April 17, 2016
Revenues:		
Restaurant revenue	$ 413,451	$ 396,770
Franchise royalties, fees and other revenue	5,106	5,356
Total revenues	418,557	402,126
Costs and expenses:		
Restaurant operating costs (exclusive of depreciation and amortization shown separately below):		
Cost of sales	94,607	92,325
Labor	145,519	132,984
Other operating	54,680	49,708
Occupancy	33,119	32,498
Depreciation and amortization	28,044	23,951
General and administrative	30,913	31,980
Selling	12,362	11,408
Pre-opening costs and acquisition costs	1,855	2,372
Other charges(1)	—	4,725
Total costs and expenses	401,099	381,951
Income from operations	17,458	20,175
Other expense:		
Interest expense, net and other	2,984	1,638
Income before income taxes	14,474	18,537
Provision for income taxes	2,907	4,312
Net income	$ 11,567	$ 14,225
Earnings per share:		
Basic	$ 0.90	$ 1.04
Diluted	$ 0.89	$ 1.03
Weighted average shares outstanding:		
Basic	12,853	13,635
Diluted	12,953	13,783

(1) Certain amounts presented in prior periods have been reclassified to conform with the current period presentation. For the first quarter of 2016, the Company reclassified litigation contingencies of $3.9 million from Selling, general, and administrative expenses and impairment charges of $0.8 million from Asset impairment to Other charges on the condensed consolidated statement of operations. Management believes separating these special items on the condensed consolidated statement of operations provides more clarity of the Company's ongoing operating performance and a more relevant comparison to prior period results.

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RED ROBIN GOURMET BURGERS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	(Unaudited) April 16, 2017	December 25, 2016
Assets:		
Current Assets:		
Cash and cash equivalents	$ 22,239	$ 11,732
Accounts receivable, net	14,239	24,166
Inventories	29,736	29,899
Prepaid expenses and other current assets	16,586	27,049
Total current assets	82,800	92,846
Property and equipment, net	656,418	656,439
Goodwill	95,935	95,935
Intangible assets, net	41,708	42,270
Other assets, net	31,301	31,055
Total assets	$ 908,162	$ 918,545
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Trade accounts payable	$ 19,257	$ 13,740
Construction related payables	15,923	12,862
Accrued payroll and payroll related liabilities	38,156	34,703
Unearned revenue	37,612	50,199
Accrued liabilities and other	39,741	29,505
Total current liabilities	150,689	141,009
Deferred rent	73,191	72,431
Long-term debt	300,875	336,375
Long-term portion of capital lease obligations	10,633	10,805
Other non-current liabilities	11,150	9,872
Total liabilities	546,538	570,492
Stockholders' Equity:		
Common stock; $0.001 par value: 45,000 shares authorized; 17,851 and 17,851 shares issued; 12,872 and 12,828 shares outstanding	18	18
Preferred stock, $0.001 par value: 3,000 shares authorized; no shares issued and outstanding	—	—
Treasury stock 4,979 and 5,023 shares, at cost	(205,881)	(207,720)
Paid-in capital	207,975	208,022
Accumulated other loss, net of tax	(4,796)	(5,008)
Retained earnings	364,308	352,741
Total stockholders' equity	361,624	348,053
Total liabilities and stockholders' equity	$ 908,162	$ 918,545

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Restaurant Development

During the first quarter of 2017, the Company opened six Red Robin restaurants, including one restaurant that was temporarily closed during 2016, and relocated one Red Robin restaurant. Our franchisees opened one restaurant during the first quarter of 2017.

The following table details restaurant unit data for our Company-owned and franchised locations for the periods indicated:

	Sixteen Weeks Ended	
	April 16, 2017	April 17, 2016
Company-owned:		
Beginning of period	465	439
Opened during the period	6	3
Acquired from franchisees	—	13
Closed during the period	(2)	(1)
End of period	469	454
Franchised:		
Beginning of period	86	99
Opened during the period	1	—
Sold or closed during the period	—	(13)
End of period	87	86
Total number of restaurants	556	540

RRGB is likely to earn $2.90 in 2017, this would be almost 14 percent below 2015 earnings, yet the stock is trading at 25 times forward earnings. A multiple of 20 or less, given the current state of the business is more reasonable. This would equal $58 a share. If guest counts do not turn positive, the stock will revisit its previous low. We started shorting this stock in 2015 in the high $70's. They are doing worse now than then, yet the stock is within a few dollars of 2015 prices. None of the restaurant analysts predicted the slowdown and the 40 percent resulting stock price decline that came after. Now they all are slapping buy recommendations and $75 price targets. The good news, even though there isn't much, is already factored into the price. We see a replay of missed revenue and earnings target ahead. Sell.