

STARBOARD INVESTS \$200-250M, INTO PAPA JOHN'S – IS PZZA A BUY OR SELL ?

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Papa John's is all over the news again. After PZZA bottomed last Friday at \$38 and change, on expectations of disappointing North American sales in Q4 and January (down 8.1% and 10.5% respectively, now announced). Observers were apparently taken by surprise yesterday morning, Monday, when it was announced that Starboard Value LP has invested \$200M in Papa John's, with the possibility of \$50M more, into a preferred stock convertible at a 22.5% premium to the average price over 10 days ending 2/15/19. Parenthetically, franchisees are allowed to purchase \$10M worth on the same terms. This will provide Starboard with a stake equal to 11-15% of Papa John's equity. Starboard will also be entitled to two Board seats, including Jeffrey Smith, CIO of Starboard.

We have written a number of times on this situation over the last six months. We liked PZZA in the high 30s, suggested lightening up in the low 50s. Lastly, on December 10th, with the stock at \$45 and change, we speculated that a deal was in the offing, with Schnatter having lived through a cooling off period and having hired an investment banking advisor.

We think PZZA is a good bet again (at \$43 and change), with more upside potential than downside risk, both in the short term and longer.

- Starboard has an excellent reputation, having invested in Darden, modifying the Board of Directors, and helping to implement some operating initiatives. Their involvement provides a floor under the stock, both short and longer term.
- While the disappointing sales in Q4 and January are a material negative, it is sometimes overlooked that there are 1,700 franchised stores internationally (1/3 of the system), and their sales were down nowhere near as much as in North America, down 2.6% for Q4 and flat in January.
- John Schnatter's influence is diminished materially, with a Board expanded by two new Directors, and his stock ownership diluted by 11-15%, to be closer to 25% than the current 30%.
- There are still hundreds of billions of dollars of private equity capital looking for a home and we believe there is sufficient potential at PZZA to justify a price at least in the low 50s, even with the recent sales trends. Starboard will end up paying close to \$50 for their stake.
- We think the chances are perhaps 50-50 that another suitor will emerge relatively soon, since the stock is more likely to firm up than decline substantially from this level and a competing investor knows that. In essence, the time to move is now !



We indicated months ago that we own this one. Though the stock is up over 10% in the last two days, we are sticking with our position. Greed has replaced Fear.

Roger Lipton