INSIDE

The Lone Ranger

By Eleanor Laise—Lone Star Steakhouse was a company ripe for a shake-up. The stock stunk, and management didn't seem to care. But could one small investor expect to make a difference? Guy Adams did. He challenged the CEO for his seat on the board—and won.

THE Lone RANGER

Lone Star Steakhouse was ripe for a shake-up.
The stock stunk, and management didn't seem to care.
Then Guy Adams came along.
What could this small-time investor expect to do? Get this:
take on the CEO for his seat on the board.

By ELEANOR LAISE
Photographs by MISCHA GRAEVENOR


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The setting

seemed the work of an overzealous location scout: a Sullivans's Steakhouse in Austin, Tex. The restaurant is named after John L. Sullivan, last of the great bare-knuckled heavyweight champions. And on a July morning last year, what would become a 12 month slugfest was about to get under way. In one corner: Lone Star Steakhouse & Saloon, the $300 million Wichita, Kan., operator of Sullivan's and 288 other restaurants devoted to all things beef. In the opposing corner: Guy Adams, a 50-year-old individual investor from Los Angeles.

Adams expected to find lots of irate shareholders in Sullivan's, for the steak chain had posted rancid results of late. Instead, only two other investors showed up. They sat facing a dais crowned by Lone Star's five directors and featuring Jamie Coulter, the company's charismatic chairman and CEO.

As Coulter and company completed their management presentation, Adams came out of his corner. He politely raised his hand - and then unloaded a roundhouse of grievances at the board with a southern drawl left over from his Louisiana youth.

"Why did Mr. Coulter receive a 150 percent pay raise in a year when profits, sales and the stock price declined?" Adams began.

"Why did [Executive Vice President] John White's salary soar more than 110 percent?"

"Why did the board reprice nearly 4.6 million options, largely to the benefit of Mr. Coulter?"

The rapid-fire interrogation was a disruption of what might have been a quiet, and brief, shareholders' meeting. And it left Coulter and White little choice but to restate the company line. Sitting at the end of the dais, Bill Greene, one of three independent directors on Lone Star's board, thought to himself, *Where the hell is this guy coming from?*

In the months that followed, they'd learn all about where Guy Adams was coming from - and where he was going.

Unknown to the board, Adams had more in mind than playing the pesky shareholder when he arrived in Austin. He was setting the stage for a much bigger role: as quirky challenger for Coulter's board seat. While it's not uncommon for dissident shareholders to make a bid for a director's seat, they're usually multimillionaire investors (think T. Boone Pickens or Carl Icahn). No one like Adams-he owned less than 0.01 percent of Lone Star, and his net worth was barely $173,000-had ever booted a CEO from the board of his own company.

And that fact wasn't lost on Lone Star's management, which pulled out all the stops to squash Adams's bid. They sued him. They publicly questioned his integrity. They even dredged up records of his divorce to prove he couldn't afford a proxy fight. But Adams was determined to succeed, no matter the obstacles. "My whole life has been spent doing things that people told me I couldn't do," Adams says.

His fight was not entirely altruistic. Adams's real aim in seeking Coulter's seat was to draw attention to himself and his modest money-management firm. "I'd like to have an institutional fund, managing $1 billion," he admits. "I needed a higher profile." But his story sends a message to any investor who has been enraged by a company's tumbling stock price and subpar performance: The shareholders own the company, not the CEO. And if the shareholders aren't happy, *nobody's* happy.

Guy Adams comes across as a decidedly average guy. A native of Baton Rouge, La., he has spent the past 15 years in southern California managing private client investments. His annual income: about $125,000. As a money manager, he's regularly on the lookout for good buys. One of his favorite resources for leads on discounted stocks is the "focus list" put out by the California Public Employees' Retirement System (Calpers). It's actually a hall of shame that spotlights what Calpers considers the country's 10 most poorly managed companies.

And it's where Adams got an early heads-up on Lone Star.

When the list appeared in February 2000, honorees included Rite Aid and J.C. Penney. But for Adams, Lone Star really stood out. The company had strong cash flow, little debt, and a high concentration of institutional ownership, including the $156 billion powerhouse Calpers. But Calpers also nailed the restaurant chain for being one of the worst performers in the restaurant industry and for refusing to consider adding two independent directors to the board.

Lone Star was just the target Adams was after. "I could look at the stock chart and see why Calpers was upset," Adams says, as he sits in his downtown Los Angeles office. "I knew there was pain and discontent among shareholders, so if I ran for the board, I could gain support."

On Feb. 29, Adams snapped up 1,000 shares. He wasn't concerned about profits. His sole motivation was to attend that summer's annual shareholders' meeting. "I wanted to see if there were other shareholders who were fire-breathers that I could talk to," Adams says.

For its part, Lone Star wasn't accustomed to such brazen attacks from shareholders. Coulter, a restaurant lifer who was once a prominent Pizza Hut franchisee, bought the company in 1991 and took it public the following year. The chain, which includes the flagship Lone Star Steakhouse as well as Sullivan's and Del Frisco's, opened an additional 259 restaurants over the next six years. And the stock, listed on the Nasdaq, soared from its offering price of $3.38 to a high of $44 in 1996. "We were hotter than Krispy Kreme," says Coulter, 60.

But in a reversal worthy of a VH1 *Behind the Music* episode, Lone Star lost its luster. In the three years ended December 1999, its stock dropped 67 percent (to $9), while the S&P Restaurant index rose 66 percent. Profit margins and same-store sales also fell three years in a row.

Analysts started to ignore the company, turned off by what even Coulter admits was poor investor relations. "They don't talk a whole lot to me," says Mike Smith of Fahnestock & Co., the sole analyst covering Lone Star today. "I have to get my information from other sources, so it's pretty sketchy. Their conference call was more confrontational than any call I've ever been on."

Still, at the end of 1999, the company's board of directors gave Coulter a 150 percent pay raise (boosting his base salary to $750,000), and three months later more than doubled the salary of his second-in-command, John White. "Our salaries were just brought up to the median for the industry," says White, a Lone Star employee since 1991. In January the board also approved the repricing of millions of stock options from $18.25 a share to $8.47. Ninety-one percent of the repriced options belonged to Coulter, White and Senior Vice President Gerald Aaron. The options were repriced "purely to retain people," White says.

But the stock continued to sink. On Dec. 26, 2000 (and six months after Adams had appeared at the shareholders' meeting in Austin), Lone Star's fiscal year ended with a 2 percent decline in sales, and its stock was at a meager $8.

Adams kept a low profile after the Austin meeting, biding his time until the start of the next proxy season. In the meantime, he laid out a game plan. He set aside $50,000, most of which would be spent on mailings to shareholders, Securities and Exchange Commission filing fees and travel to lobby institutional investors. That didn't leave Adams much cash for one obvious necessity: lawyers. Luckily, he had friends. One such friend, Craig Tompkins, a Los Angeles attorney, offered free tips on securities law. Tompkins also put Adams in touch with John Quinn, a partner at the 120-man litigation firm Quinn Emanuel Urquhart Oliver & Hedges, who agreed to take the case on the condition that he be paid only if Adams recouped his expenses from Lone Star.

In February, with his stake in Lone Star at 1,100 shares (worth about $9,500), Adams contacted several institutional investors to test the waters. He'd simply call corporate governance officials and pose a casual question: "How would you feel if someone were to run for the board seat at Lone Star Steakhouse?" Then he outlined a litany of grievances against the company: excessive executive compensation, repricing of stock options, and "golden parachute" contracts that granted Coulter generous amounts of stock or cash upon a change in the composition of the board.

One director who took Adams's call was Ted White of Calpers. "He impressed me right off the bat," says White, director of corporate governance for the pension fund. "He made good

Steak Out: Not only did Lone Star's stock struggle, but profits from its 289 restaurants fell 77 percent between 1997 and 2000.

points that the company was undervalued, and he gained credibility with us."

In late February, Adams made his first filing with the SEC and formally announced his campaign for a seat on the board. Only one spot would be up for grabs in 2001: That of CEO Jamie Coulter. "I knew it would be hard for institutions to support dethroning a chairman," Adams says. "I had to think about it long and hard. But I just had to say *c'est la vie*."

Not only was Adams going up against the CEO, but against a CEO with 2.4 million Lone Star shares – or nearly one-quarter of the 10 million votes needed to win the seat. It was the kind of mismatch Vegas oddsmakers wouldn't touch. Plus, Coulter and his crew weren't going to pave the way for an upset.

Adams ignited the battle on Apr. 6, when he sent Lone Star executives a copy of his "proposed letter to shareholders," asking them to review the document for any errors. The letter was the equivalent of a campaign speech. He made his case for greater independence of the board ("[Are the] actions of the three independent directors and board consistent with the company's stock performance or operating performance?") and complained about decisions made under Coulter's watch – such as the adoption of golden parachute contracts that, he said, were "outrageous in light of the company's dismal performance."

Lone Star didn't respond to the letter.

A week later Adams tried again. This time the company responded – with a vengeance. On Apr. 20, Lone Star filed a lawsuit against Adams in a Wichita federal court. The company claimed that rather than acting independently, as he'd said in his proxy filing, Adams was "a stalking horse" for others who were secretly funding his campaign. The complaint called Adams's SEC filings "vitriolic and highly misleading."

With the court's approval, Lone Star launched a thorough investigation of Adams. Company attorneys pored over his phone bills and brokerage statements, searching for evidence of a hidden accomplice. They even plumbed his 1999 divorce records. And after finding that his company, GWA Capital, had reported revenue of only $39,000 that year, Lone Star claimed that he was "virtually insolvent." "He didn't have the money to buy a new car, let alone wage a proxy fight," which can cost over $100,000, claims Fred Chaney, an independent director. "That money had to be coming from someplace. We had to find out who we were really up against."

Calpers's White had a different take on the lawsuit. "This litigation was meant to spend Guy Adams out of the race," he says.

While both sides dealt with the lawsuit, they also had to lobby the institutional investors whose votes would decide the July 6 election. But Coulter's PR efforts weren't always too polished. In a meeting with David Einhorn, a partner at Greenlight Capital, Lone Star's fifth-largest shareholder, Coulter mentioned that he intended to "get all the leeches out of the stock."

"Are you calling your shareholders leeches?" Einhorn asked.

Coulter insists he was referring to individuals who attempt to manipulate the stock and spread rumors about the company. But Einhorn couldn't forget the remark. "This was the first time the company had reached out to me," Einhorn says. "And Coulter demonstrated the attitudes I suspected existed from his other actions."

Adams's political forays were more successful. In a meeting with Institutional Shareholder Services (ISS), the highly influential research service that recommends proxy votes for institutional investors, Adams swayed Vice President Patrick McGurn to his side. "Guy was very candid with us," says McGurn. "He said he didn't know much about the restaurant industry. But we determined that this board could use a burr under its saddle." Adams also won over several major shareholders, including Greenlight Capital and Amalgamated Bank. Their combined shares totaled more than 1 million votes.

Meanwhile, Lone Star's campaign against Adams escalated. In June it took out a full-page ad in the New York Times, saying, "Guy Adams is not the 'independent' voice he portrays himself to be." Then, in a letter to shareholders, Lone Star asked, "Can you trust Guy Adams? We don't think so! We urge you to consider whether Guy Adams is acting on your behalf, as he asserts, or at the behest of activists with unknown political agendas."

Fallen Star

Since peaking at $44 in 1996, Lone Star (STAR) stock has dropped 72 percent, well behind competitors.

Source: Dow Jones Interactive

The campaign, and the public scrutiny, wore on Adams. He put his money-management business on hold to devote 14-hour days to the campaign and the lawsuit. "Their strategy was to bury me with work," he says. "I was reviewing legal papers, working the phones, catching up on correspondence on weekends." What kept him going? The dozens of letters and e-mails he received from fellow Lone Star shareholders. "In the midst of war, for someone to say thanks for what you're doing..." He trails off. "Sometimes you lose track of what you're doing. You're just fighting. You have to stop and say, 'Why am I doing this again?'"

U.S. District Court Judge J. Thomas Marten put that question to rest on June 25. His decision: Lone Star had failed to prove Adams was working with secret partners. The company, Marten wrote, "resorts to innuendo and assumption to establish the existence of other participants."

For many institutional shareholders, the court decision stamped Adams with the Good Housekeeping seal of approval. After all, they were looking for a director who would be independent in spirit as well as in name. "By any measure, you could say Adams is independent from management," says McGurn of ISS. "They pulled out a machine gun to kill a mosquito."

Within days both ISS and Proxy Monitor, another proxy research firm, formally announced their support for Adams – a major triumph, since 850 institutional investors subscribe to the services' recommendations. Days later Adams won Calpers's 300,000 votes. Suddenly, an upset was in the making. "I knew I had the votes," Adams says. "I knew I had it."

As it turns out, he couldn't rehearse his victory speech yet. On Monday, July 2, Adams rushed to his office to read the fax he received each morning from ADP, the firm responsible for collecting and counting the votes. This morning's fax left him stunned. Just four days before the election, he had only 5 million votes to Coulter's 7 million. "Shit, this isn't working out," Adams thought. "The numbers just aren't adding up."

He sat down and studied the fax. Then he saw it: An institution that owned 1 million Lone Star shares had voted only 400,000 in Adams's favor. He immediately picked up the phone.

"Only 400,000 shares came through," he recalls telling the shareholder. "What's going on?"

"You're crazy, Adams," the investor said. "I'll check on it, but you're wrong."

An hour later the phone rang. "You were right," the investor told Adams. A computer glitch had misdirected the votes.

Over the next two days, more votes would come in, making the July 6 shareholders' meeting, in the end, anticlimactic. That morning, in the same Sullivan's where Adams and Coulter first met face-to-face, Lone Star executives anxiously waited for an 11th-hour reprieve. It never came.

"The vote wasn't close," Adams says. In fact, he had won the election with 10.6 million shares - 2.3 million more than Coulter. "It was a decisive victory."

The scene: Del Frisco's in Manhattan. It's two weeks since the Lone Star election, and the directors are having a painstakingly polite dinner the night before their first meeting with Adams on board. At one point, Coulter stands and raises his glass. "I'd like to welcome the newest member of our board," the deposed chairman says, then glances at Adams.

"In spite of any hard feelings, he mustered a very gracious gesture," Adam says now.

The civility doesn't last long. A few days later, in his Wichita office, Coulter makes it clear he hasn't forgotten the fight: "Adams made a very personal attack on the integrity of our directors."

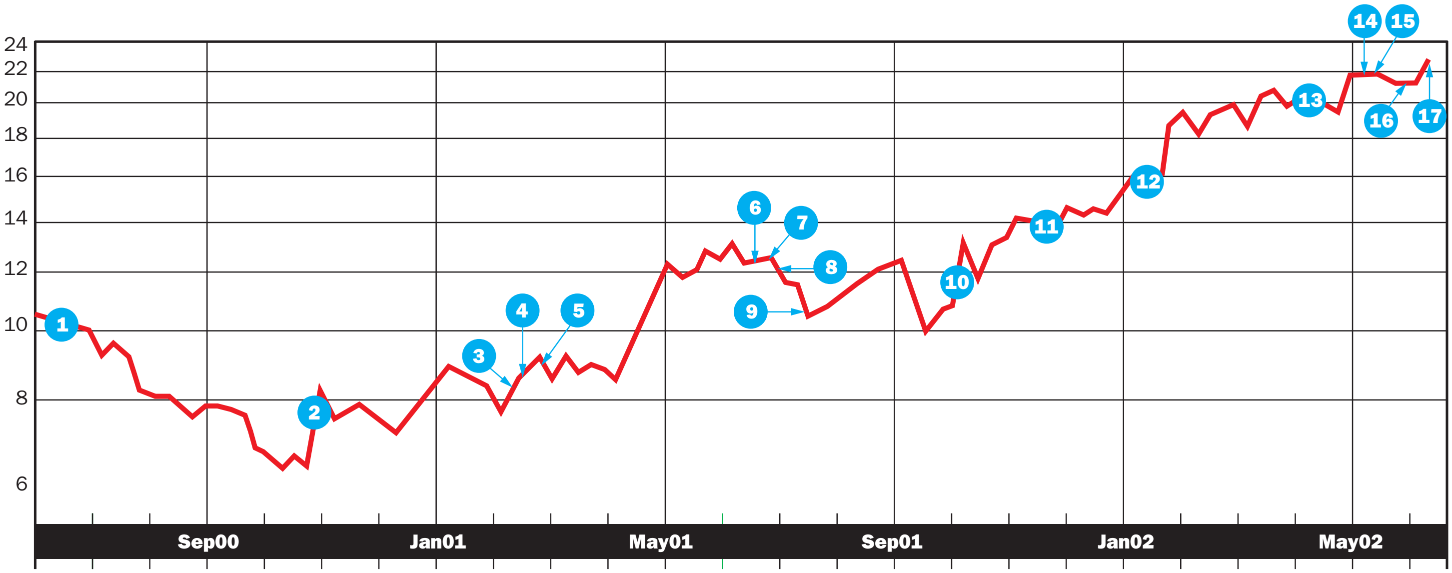
Other directors are less restrained. "He's a no-name with no stock backed by a bunch of gorillas," independent director Bill Greene says of Adams. "Coulter owns 12 percent of the company. Adams owns 0.007 percent. I'm a believer in the golden rule. Those that got most of the gold make most of the rules."

Adams knows he won an election, not a new set of friends. Still, he has an agenda for his three-year term: He wants to add two independent directors to the board and improve the company's communication with shareholders.

It's those shareholders, you see, who remain his outspoken backers. "Adams is one vote on a five-member board," Greenlight Capital's Einhorn says. "But he's a smart, honest guy, and he'll do the best he can for shareholders, which is more than I can say for the other directors." SM

Anatomy Of A Turnaround: Lone Star Steakhouse

During Mr. Adams' involvement with Lone Star the stock increases from $8.98 to $21.44 per share for a 139% increase in 16 months.



June 9, 2000
1 Mr. Adams attends Lone Star's annual meeting and publicly questions the Chairman and Directors.

October 26, 2000
2 Mr. Adams begins meeting with institutional shareholders to discuss Lone Star situation.

Feb. 6 - 21, 2001
3 Mr. Adams purchases 1,100 shares between $8.56 and $9.78 per share, at an averaged price of $8.98 per share.

February 14, 2001
4 Mr. Adams receives general expression of support for his candidacy from 3 institutional shareholders representing over 13% of the outstanding stock.

February 23, 2001
5 Mr. Adams filed his Preliminary Proxy materials with the SEC.

June 18, 2001
6 Mr. Adams mails letter and proxy cards to Lone Star's shareholders.

June 26, 2001
7 Institutional Shareholders Services (ISS) endorses the election of Mr. Adams.

June 29, 2001
8 The California Public Employees' Retirement System (CalPERS) endorses the election of Guy W. Adams.

July 12, 2001
9 Mr. Adams is elected to the Board, defeating the former Board Chairman and largest shareholders. Excluding shares owned by management, Mr. Adams receives 2 out of every 3 votes cast.

October 4, 2001
10 Lone Star announces it has retained UBS Warburg to explore options for enhancing shareholder value, including the sale of the company.

November 15, 2001
11 Lone Star announces the expansion of the Board by 3 additional "non-management" directors, the removal of the poison pill, and the declassification of board to be voted upon by shareholders.

January 9, 2002
12 Lone Star increases quarterly dividend by 20% to $0.15 per share, or $0.60 per share per year.

April 2, 2002
13 Lone Star announces signed letter of intent to sell company at $20.50 per share, all cash. (Price is later increased to $21.50 /share.)

May 6, 2002
14 Letter of intent to sell Lone Star expires.

May 9, 2002
15 Lone Star announces share buyback using a modified dutch-auction at a price between $20.50 and $22.50 per share.

May 29, 2002
16 Mr. Adams resigns from Board of Lone Star after picking his successor.

June 14, 2002
17 Lone Star dutch-auction ends with 4 million shares bought back at an average price of $21.375 per share.