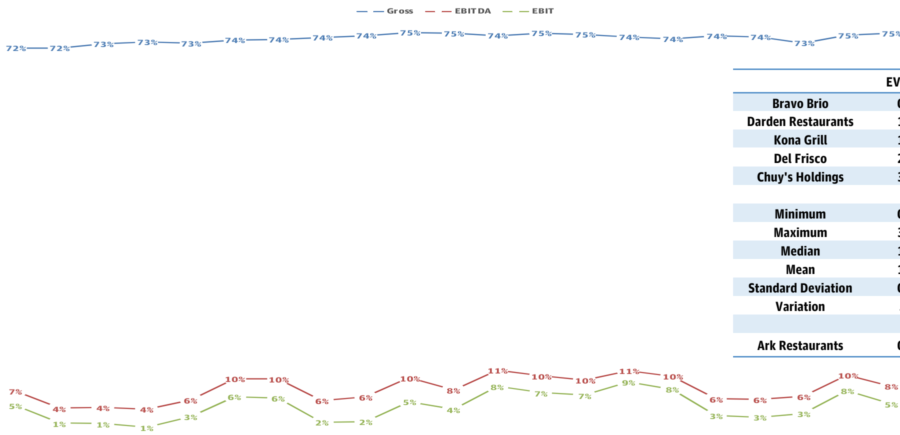
SINGULAR DILIGENCE

Ark Restaurants (ARKR)

Ark Restaurants (NASDAQ: ARKR)
Stock Price: $22.20



	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Bravo Brio	0.75	1.00	7.20	13.57	5.37
Darden Restaurants	1.06	4.79	8.69	13.98	10.94
Kona Grill	1.62	2.23	14.04	29.12	17.13
Del Frisco	2.30	3.30	16.24	22.97	17.24
Chuy's Holdings	3.21	4.41	27.03	42.61	32.46
Minimum	0.75	1.00	7.20	13.57	5.37
Maximum	3.21	4.79	27.03	42.61	32.46
Median	1.62	3.30	14.04	22.97	17.13
Mean	1.79	3.15	14.64	24.45	16.63
Standard Deviation	0.89	1.40	7.03	10.79	9.06
Variation	50%	44%	48%	44%	54%
Ark Restaurants	0.51	0.68	6.06	10.10	5.21

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Min	Max	Median	Mean	Standard Deviation	Variation
Sales	56	60	74	78	105	119	112	120	128	115	117	116	116	116	124	125	115	118	139	138	131	56	139	116	111	23	21%
Gross Profit	40	44	54	57	77	87	82	89	95	87	87	86	87	87	92	93	86	87	102	103	98	40	103	87	82	18	22%
EBITDA	4	3	3	3	6	12	11	7	8	11	9	13	12	11	14	13	7	7	9	14	11	3	14	9	9	4	41%
EBIT	3	1	1	0	3	8	7	2	2	6	5	10	8	8	11	10	3	3	5	10	7	0	11	5	5	3	64%
Receivables			1	1	2	3	3	4	4	3	3	2	3	4	4	4	4	3	4	4	4	1	4	3	3	1	31%
Inventory			1	1	2	2	2	2	2	2	2	2	2	2	2	1	2	2	2	2	2	1	2	2	2	0	22%
PP&E			10	15	23	26	27	38	37	29	29	25	24	24	22	22	25	25	24	25	26	10	38	25	25	6	25%
Working Liabilities			4	5	6	7	8	10	11	10	9	8	7	7	7	8	8	9	11	12	12	4	12	8	8	2	26%
Net Tangible Assets			7	12	20	24	25	35	32	24	25	22	21	23	21	20	22	20	18	18	19	7	35	21	21	6	28%
MARGINS																											
Gross Profit	72%	72%	73%	73%	73%	74%	74%	74%	74%	75%	75%	74%	75%	75%	74%	74%	74%	74%	73%	75%	75%	72%	75%	74%	74%	1%	0.01
EBITDA	7%	4%	4%	4%	6%	10%	10%	6%	6%	10%	8%	11%	10%	10%	11%	10%	6%	6%	6%	10%	8%	4%	11%	8%	8%	2%	0.32
EBIT	5%	1%	1%	1%	3%	6%	6%	2%	2%	5%	4%	8%	7%	7%	9%	8%	3%	3%	3%	8%	5%	1%	9%	5%	5%	3%	0.60
TURNS																											
Sales/Receivables			68.15	59.06	55.38	45.80	34.67	26.66	32.03	40.51	43.72	47.87	37.75	29.09	27.72	29.33	31.11	34.99	37.43	34.10	36.34	26.66	68.15	36.34	39.56	11.34	29%
Sales/Inventory			113.51	75.85	65.66	59.35	57.76	59.20	60.12	57.24	59.46	62.07	69.08	70.50	80.52	84.55	74.13	73.63	85.44	86.84	83.02	57.24	113.51	70.50	72.52	14.31	20%
Sales/PPE			7.56	5.26	4.58	4.54	4.11	3.14	3.44	3.94	3.97	4.58	4.87	4.81	5.62	5.58	4.61	4.79	5.89	5.58	5.10	3.14	7.56	4.79	4.84	0.99	20%
Sales/NTA			10.41	6.48	5.15	4.92	4.50	3.46	3.99	4.84	4.74	5.38	5.44	5.09	5.93	6.21	5.26	5.81	7.76	7.47	6.89	3.46	10.41	5.38	5.78	1.57	27%
RETURNS																											
Gross Profit/NTA			759%	475%	376%	362%	332%	256%	297%	363%	355%	400%	408%	380%	440%	459%	392%	431%	567%	557%	516%	256%	759%	400%	428%	114%	0.27
EBITDA/NTA			46%	26%	30%	48%	44%	20%	25%	48%	36%	61%	56%	48%	67%	64%	32%	34%	50%	78%	58%	20%	78%	48%	46%	16%	0.35
EBIT/NTA			14%	4%	14%	31%	28%	6%	7%	26%	19%	45%	39%	34%	54%	48%	15%	15%	25%	56%	35%	4%	56%	26%	27%	16%	0.60
GROWTH																											
Sales		8%	22%	5%	35%	12%	-6%	7%	6%	-9%	1%	-1%	0%	0%	7%	1%	-8%	2%	18%	-1%	-5%	-9%	35%	2%	5%	11%	2.25
Gross Profit		8%	24%	6%	35%	13%	-6%	8%	7%	-9%	1%	-1%	1%	0%	6%	0%	-8%	2%	17%	1%	-5%	-9%	35%	2%	5%	11%	2.13
EBITDA		-39%	28%	-3%	93%	90%	-6%	-37%	18%	42%	-22%	48%	-10%	-8%	27%	-8%	-46%	0%	31%	61%	-25%	-46%	93%	-1%	12%	40%	3.45
EBIT		-68%	14%	-48%	459%	172%	-10%	-72%	11%	194%	-27%	108%	-14%	-6%	47%	-14%	-67%	-8%	50%	130%	-36%	-72%	459%	-7%	41%	125%	3.07
Receivables			0%	43%	45%	30%	20%	55%	-54%	29%	-34%	27%	26%	34%	-3%	-6%	-22%	7%	14%	4%	-26%	-54%	55%	14%	10%	29%	2.92
Inventory			114%	32%	75%	-5%	-2%	11%	-1%	-9%	4%	-13%	-7%	4%	-16%	10%	-1%	7%	-2%	-3%	1%	-16%	114%	-1%	11%	32%	3.05
PP&E			17%	81%	41%	-6%	15%	62%	-43%	17%	-14%	-13%	2%	0%	-17%	24%	1%	-4%	-4%	13%	-4%	-43%	81%	1%	9%	29%	3.23
Working Liabilities			23%	10%	23%	-3%	32%	34%	-5%	-12%	-7%	-22%	7%	-14%	23%	3%	5%	16%	22%	-5%	4%	-22%	34%	5%	7%	16%	2.26
Net Tangible Assets			16%	115%	50%	-4%	10%	67%	-52%	31%	-18%	-6%	3%	11%	-25%	25%	-5%	-9%	-14%	22%	-13%	-52%	115%	3%	11%	37%	3.46

SINGULAR DILIGENCE

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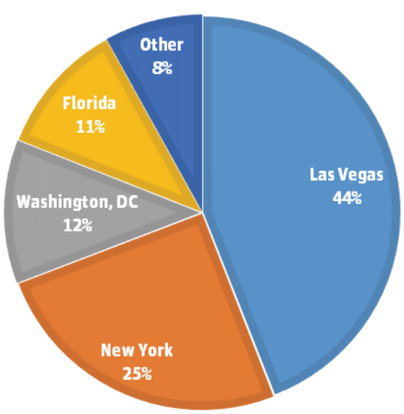
Ark Restaurants (NASDAQ: ARKR) Runs Big Restaurants in Landmark Locations

OVERVIEW

Ark Restaurants operates mostly very large restaurants in mostly landmark locations. The company did not start out that way. It was founded in 1975 by Michael Weinstein: "The first one was originally 60 seats. Primarily I was looking for an opportunity with a good friend. We were living on the Upper West Side of Manhattan, and there was really no place we wanted to eat in, nothing that addressed our needs. So we built something that would be a place where we would be comfortable sitting, with a menu that we liked. What made it an unusual restaurant at the time was that the whole front of the restaurant was open to the street, so we had this sort of café atmosphere where people could see in and see out easily. Nobody did that in 1975, and nobody had high ceilings. You used to build restaurants in 1975 with their own environments that didn't interact with the street, and this became something unusual. We expanded it to 100 seats and were doing really, really well. I think we invested $7,000 to build that restaurant. The first year the bottom line was $400,000, so it was a stunning success."



Ark gets 92% of its sales from 4 markets: Vegas, New York, D.C., and Florida

Ark repeated its success with different restaurants. It never expanded on the original concept. Instead it built restaurants in the same neighborhood using different names. The first was called Museum Café. The second was an Italian restaurant called Peretti's. Then the company made its first acquisition of a Thai restaurant called Teacher's. Each restaurant was in the same neighborhood but used a different name. This model of running individual restaurants instead of a single chain is the same one Ark stuck to for the next 40 years.

In the 1990s, Ark slowly transitioned to a focus on just its larger and landmark locations. This strategy was based on experience. Ark eventually gained experience running both large and small restaurants. The management found that the large locations had unique advantages that the small locations did not. Weinstein explained the transition in his 1999 letter to shareholders: "We have mostly completed the transition from an operation of moderately sized neighborhood restaurants to that of an operator of high volume multi-concept food facilities. Consistent with this transition we sold two more restaurants: An American Place and Beekman 1766 Tavern, and at year end we were in contract to sell B. Smith's Washington D.C. and Peretti's Italian Café. Our larger sites have competitive advantages. There is a natural flow of customers to entertainment sites, public parks, waterfronts, and train stations. Sales at our restaurants in these locations require considerable capital and expertise and therefore we generally operate with less competition and healthy demand to supply ratios."

In the 2000s, Ark moved even further into the large, landmark venue business. The company operates restaurants in New York City, Boston, Washington D.C., and several gambling centers (Las Vegas, Atlantic City, Connecticut, and Florida). Ark also has an 11% stake in the Meadowlands in New Jersey. Gambling is not allowed in the Meadowlands. However, Ark invested in the Meadowlands so it would have the food and beverage business for the Meadowlands if and when New Jersey passes legislation allowing gambling outside of Atlantic City. Ark's partners obviously want gambling in the Meadowlands. And Ark made the investment as a kind of "lottery ticket" where Ark will break even on its management contract if the site is not developed further – it is currently just a horse racing track running harness races – and make a lot of money if the Meadowlands is ever developed into a center of legalized gambling.

In addition to the 11% stake in the Meadowlands, Ark is the majority (64%) owner of a partnership that owns the Tampa and Hollywood Food Courts. These are the food courts for the Hard Rock Hotel and Casino in Tampa, Florida and the Hard Rock Hotel and Casino in Hollywood Florida. Each food court seats 250 people. The leases on the food courts expire in 2029.

Ark operates food courts in other casinos as well. In New-York New-York (Las Vegas) Ark runs 6 small food court restaurants (fast food) and one full service restaurant in addition to all of that hotel's room service, banquet, and employee dining.

In total Ark runs "20 restaurants and bars (and) 22 fast food concepts and catering operations". However, these numbers suggest Ark is more diversified than it really is. Ark's strategy is to focus on "larger, destination properties intended to benefit from high patron traffic attributable to the uniqueness of the location." This is obvious in a list of Ark's largest restaurants. For example, Durgin Park Restaurant and the Black Horse Tavern are located in Faneuil Hall in Boston. Ark has run those restaurants since 2007. The current lease expires in 2032. Those restaurants have a total of 575 seats (all indoors).

The size of each Ark restaurant is best understood relative to a reference point many people have eaten in. Bloomin Brands operates several concepts. The largest store formats are for their Outback Steakhouse and Carraba's Italian Grill. These two concepts average 6,200 square feet with 220 seats and 6,500 square feet with 250 seats.

Ark has a few restaurants that are smaller than that. For example, the company opened "Robert" in 2009. This is a 150 seat (5,530 square foot) restaurant in the Museum of Arts & Design in New York City. Like many of Ark's investments, this one was made because of a favorable combination of rent and location. In 2009, CEO Michael Weinstein explained: "…we have not done anything in New York City for seven or eight years…because we could not find a rent that made sense. The Museum of Arts and Design is an anomaly. I mean we got a below market rent because they wanted us, and that rent will be below market forever. I don't care where rents (go)…that rent will always be cheap." The lease on the Museum of Arts and Design location runs for another 21 years.

Even Ark's worst performing restaurant – Clyde Frazier's Wine and Dine – in New York City has a favorable lease. The 10,000 square foot restaurant with 250 seats opened in 2012. The lease expires in 2032. Clyde's has performed far below expectations. It lost $1.8 million in 2012. As of early 2013, management reported that Clyde's looked like it was going to breakeven on a cash flow basis for the first month in its history. Clyde's hurt 2012 EBITDA and did not contribute to Ark's results in 2013. The rent differential between what Ark leases Clyde's location at and what the same frontage a block south of the location (37th to 38th street on 10th Avenue) goes for is significant. Quan estimates that Ark could make $400,000 a year just by closing Clyde's and subletting the location. This suggests the lease actually has a value of $3.2 million for Ark (the $400,000 a year difference in the market rate and Ark's rent capitalized at 8 times).

In February 2013, Landry's – a private company that had previously acquired the restaurant chains McCormick & Schmick's and Morton's – offered $22 a share to acquire all of Ark. Ark's board rejected the offer the following month. Landry's reiterated the offer. Ark took no further public action after rejecting the offer. Michael Weinstein owns 34% of Ark. The stock is very illiquid. A sale of the company would only occur if Weinstein favored it. Weinstein is 70 years old. It is possible he may consider a sale if he wants to retire from managing the company he founded. However, the $22 a share offer from Landry's – despite providing a 22 percent premium to Ark's then $18 stock price – was not even an especially attractive opening bid.

Normal pre-tax owner earnings is estimated to be $11.2 million before tax. That would be $7.28 million after tax. Ark has 3.26 million shares outstanding. This suggests earning power is about $2.23 a share. An offer of 10 times normal after-tax earnings is low for a restaurant company with no debt.

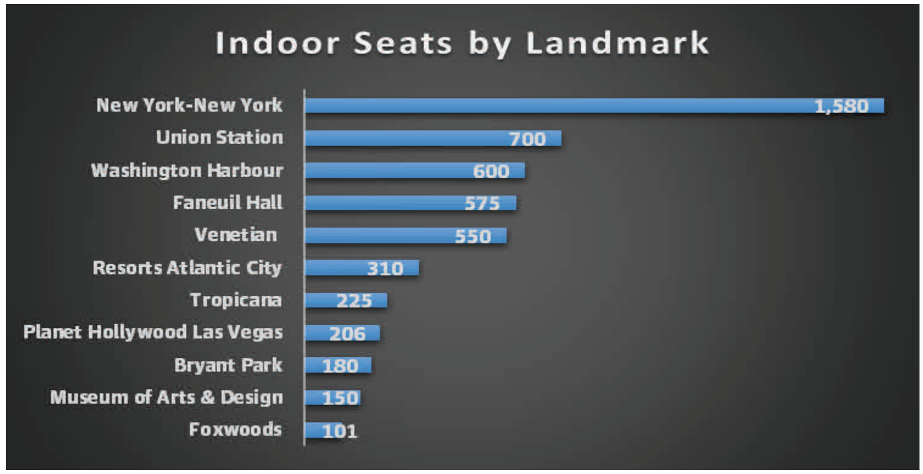
DURABILITY: *Ark is a Durable Business with No Place to Reliably Deploy its Excess Cash*

The demand for eating out is completely durable. Over the last 40 years, the percent of U.S. restaurant spending has been steady at 4% to 5% of GDP. Restaurant chains grow and decay because of competition with other concepts not because of industrywide shifts in demand. Gross profitability is usually very stable. The markup on food and beverages in percentage terms barely changes at all. For the last 20 years, Ark has generally taken a $3 food input and marked it up 4 times to become a $12 menu item. Gross costs are usually about 25% of sales. While operating expenses – mostly payroll and rent – are often around 65% of sales. Restaurants have no problem passing on inflation to customers in normal times. Losses are caused by an inability to generate enough traffic in a specific location. During recessions or tough competitive environments, specific restaurants may adjust pricing to generate sufficient volume. But this is a very minor tool compared to other industries. Overwhelmingly, restaurants compete for traffic on factors other than trying to survive on thinner gross margins. Expensive restaurants tend to have higher food costs. Cheaper restaurants tend to have lower food costs. The differences in gross margins are not as great as in some industries. So competition from a low cost producer is less of a concern. Local competition is a huge concern for any restaurant. And competition that hits at the uniqueness of a certain restaurant or concept is the biggest concern.

Ark may experience some declines in revenue and EBITDA as long-term leases roll off and are not replaced. These declines are different from poor sales performance at larger companies. For Ark, closing a successful location – because the lease is not renewed – is similar to shutting down an entire business line. Revenue and EBITDA tend to decline proportionately. This is very different from closing an unsuccessful restaurant. Unsuccessful restaurants usually cause large losses immediately and then are closed fast. The best example of a concept that is failing right now is Clyde's Wine and Dine in New York City. The lease on Clyde's expires in 2032. If Ark chooses to shut down the restaurant, it will do so soon. It is unusual for Ark to experience more than a few consecutive years of losses at one location, because Ark – like other restaurant operators – shuts down failed experiments quickly. The failure rate for new restaurants is high. And irreversible failure is usually obvious within 6 to 18 months of opening. The culprit is almost always insufficient revenue relative to operating expenses. For example, Clyde's is too large a location to be treated as just a sports bar. However, the restaurant has been unable to attract enough customers to eat in the dining room rather than drink at the bar. This disconnect between the creator's design for a concept and the audience's reception of that concept is what leads to losses Flops happen fast. After the first few years of opening, Ark's restaurants are very rarely closed for any reason other than a prohibitive rent increase at the end of the lease period.

MOAT: *Ark's Moat is its Landmark Locations*

Ark's competitive advantages are location based. The company focuses on making deals that give it unique restaurants in unique locations. This reduces the extremely local competition for customer traffic that makes the restaurant business difficult. Ark aims for a mass audience. Most of



5,177 (93%) of Ark's 5,557 indoor seats are located at landmarks

Ark's restaurants seat between 300 and 1,000 people. Many have a lot of outdoor seating. Ark is able to serve 10,000 guests a day at New York-New York in Las Vegas. As a result, the company does not target the high end of full service dining. In some areas, this puts Ark's prices far below the competition. Michael Weinstein explained this using Gallagher's steakhouse in Las Vegas (the original is in New York City) as his example: "…Gallagher's is not a high-end steakhouse at New York-New York. We're $10 (to) $15 below everybody else. All of our other restaurants, by the way, are very moderately priced: $23 (to) $24 averages at dinner; $11 to $18 check averages at lunch. We're not playing that other game."

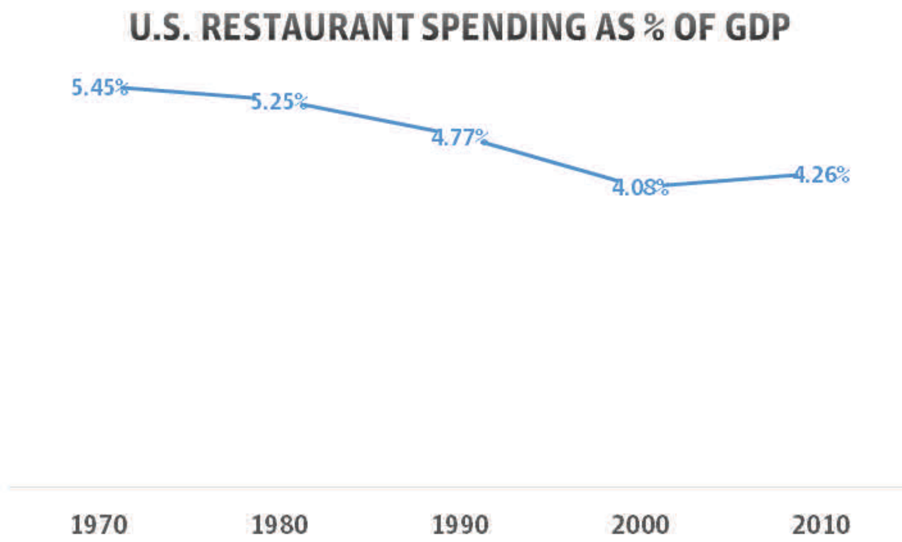
The capital investment for each restaurant is usually larger than what individual restaurant owners like to put into a new site. For example, Ark sunk $7 million into Clyde's Wine and Dine in New York City. The restaurant business is risky. The locations Ark wants usually involve some cap-ex and a long lease commitment. In recent years, Ark has often been able to avoid putting up much of the cap-ex itself. Instead partners at casinos and other venues have invested significant amounts of their own money as part of an agreement with Ark. Ark's focus on high traffic locations at casinos, train stations, etc. provides several potential limits on competition. One, it is not easy to find available real estate. There are a limited number of potential sites for a restaurant in (or very near) a city park, a train station, a casino, a hotel, etc. Even when Ark's partner has no preference for Ark over another restaurant operator being in the same location, it may be impossible to open more than a few restaurants in such a prime location. Two, it can be difficult to convince hotel owners to switch providers. When Ark provides food service for a hotel, its kitchen may be put to multiple uses. For example, Ark may be serving guests room service, operating a restaurant in the hotel, and providing employee dining for the hotel staff. Hotels may want multiple restaurants in the same structure. However, they do not need multiple providers of these other services. The locations are leased for long periods of time. This creates a little more of a partnership situation than exists when renting space from a landlord on a city street. The hotel operator may be more likely to consider the restaurant operator a partner in providing food at the site. They may be more likely to work with the same partner again. These advantages are small. But Ark does focus on big and complicated projects that are unique (not part of a chain).

Ark is especially focused on hotels and casinos. About 40% of Ark's sales now come from Las Vegas. The only revenue in New Jersey that Ark has comes from Atlantic City (a casino town) and The Meadowlands (a racetrack that Ark hopes the New Jersey legislature will one day allow to have other forms of gambling). Ark is much more focused on combination hotel casinos

Ark does not run a chain of restaurants using the same concept. Only a couple of its restaurants use the same name. And they are situated far from each other. Ark manages its restaurants by city and then by individual restaurant. The organization does not manage anything based on brands. This makes Ark different from most publicly traded restaurant companies. There are positives and negatives in these differences.

The biggest negative is the extreme difficulty in growing the business. Investors in restaurant stocks are often looking for fast growth. The surest way to have fast growth for many years to come is to have a great concept that works in one market and can be moved from city to city and state to state. Restaurant chains focused on U.S. suburbs can grow to more than one thousand stores. The market opportunity for a single concept is sometimes huge. In 2010, Outback Steakhouse had 980 locations averaging about 220 seats each. That is a capacity of almost 216,000 seats. Each Outback location is fairly comparable to an Ark restaurant in terms of average price per person, dinner business versus lunch business, and alcohol versus food sales. Ark restaurants are unusual in that they are one off full service restaurants, but their size (very big) and pricing (very reasonable) are more in line with casual full service chains than the kind of fine dining found in many cities. This has become even truer as Ark transitioned to a focus on high traffic locations. As a result, investors may be unsure of how to classify Ark.

In many (store level) respects, Ark is similar to restaurant chains like Bloomin Brands (the owner of Outback). However, in one respect it is completely different. Those chains tend to focus on growth. They have an easily repeatable business model. Ark does not. As a result, Ark has often had a very high dividend yield. At times, the company has paid out nearly all of its free cash flow. Over the last 10 years, the stock has averaged a dividend yield of 5%.



Over the last 44 years, U.S. restaurant spending has grown 6.5% a year

This is extraordinarily high for any American stock. It is also high for a restaurant stock. The reason for this high payout is a very low reinvestment rate. Ark's capital spending has averaged $3.5 million a year over the last 10 years. The reason for paying dividends is that Ark does not have other places to put its cash. It has sometimes acquired other restaurants in their entirety. And it has increased its stake in the Hard Rock food court partnerships. It also invested in the rather speculative Meadowlands venture. But it does not build new locations from scratch.

Ark is a location based restaurant business. It focuses on getting the right rent on the right locations. It also tends to use partners that put up some of their own capital. This means that Ark's durability is only as strong as the durability of its leases. The company sometimes vacates locations when it feels the new rent would be too high. Lease agreements differ. However, they commonly have a term of about 15 years with 1 or 2 renewal periods of 5 more years. This means Ark is often renting space for 15-25 years. Some rents are significantly below market rates. This is because Ark is a preferred partner for certain kinds of projects. Michael Weinstein explained this well in a 2007 earnings call: "We like the fact that we are requiring developers or investors to put up (a) big hunk of money in all of these projects. So there is not a lot of stuff that comes our way, but the reputation we have is we do big better than anybody else…or at least as good as anybody else. So if you have something that is big and complex, technically difficult, they come to us. And we have our business terms, and we stick to them, and we don't amend those business terms just because we get excited about a project. We learned a long time ago that getting excited about a project does us no good."

Ark's management tends to sacrifice growth to preserve returns on capital. The best example is the decision Ark made not to relocate Lutece to a Midtown Manhattan location Chef Eberhard Muller wanted. Weinstein called the lease costs "exorbitant"… Muller left the company as a result. In 2000 Weinstein explained his reasoning: "We cannot afford to go into a business with (a) poor or no return on investment. What might be a great idea for Eberhard may not be a great idea for me if there is no return on investment…It may be wonderful, earthshattering, first of its kind, but my shareholders have to be satisfied…and even though you are a prominent chef-partner in my business, if your interests conflict with my shareholders' interests, then a deal is not going to be done."

than other restaurant companies are. This model is somewhat repeatable. For example, Ark runs the food court at the Tampa, Florida Hard Rock and the Hollywood, Florida Hard Rock.

With the exception of Las Vegas, there is no durable moat around the casinos Ark operates in except the laws that limit competition. These laws have been relaxed on the East coast. More and more Indian casinos have been added. Ark's east coast sites in Connecticut (Foxwoods) and New Jersey (Atlantic City) face more competition from other gambling sites in the Washington D.C. to Boston metro area. This used to be an area with a lot of potential gamblers and very few places to gamble. That has changed recently. And seems likely to change even further. This is especially negative for Atlantic City. Gambling revenue at Atlantic City is down about 40% from its peak. Ark does not expect Atlantic City to recover to its former glory. However, Ark's management did mention that The Meadowlands it situated in a location where it could potentially be as big as Atlantic City ever was. This is speculative. However, Weinstein is correct. The Meadowlands is an ideal location for gambling. Atlantic City was never centrally located. It was just the only cluster of casinos in the east, because it had legalized casino gambling long before anyplace else in the Washington D.C. to Boston region.

Las Vegas has also declined from its peak. However, Ark's management is not concerned about a permanent decline in Las Vegas. Vegas is a unique location. It has become something of an adult's Disney World. It now has some of the best entertainment and dining in the United States. It also has some of the best accommodations. Gambling is what got the snowball rolling for the creation of an entertainment zone in Las Vegas. But it has now developed uniquely attractive features that are unlikely to be replicated elsewhere. Many people already fly to Las Vegas despite having closer gambling options. For example, Las Vegas attracts gamblers from the New York, New Jersey, and Connecticut area despite all of those people being within a few hours' drive of casinos. Las Vegas is unique in being the greatest concentration of gambling, entertainment, food, and accommodations that make it a tourist destination.

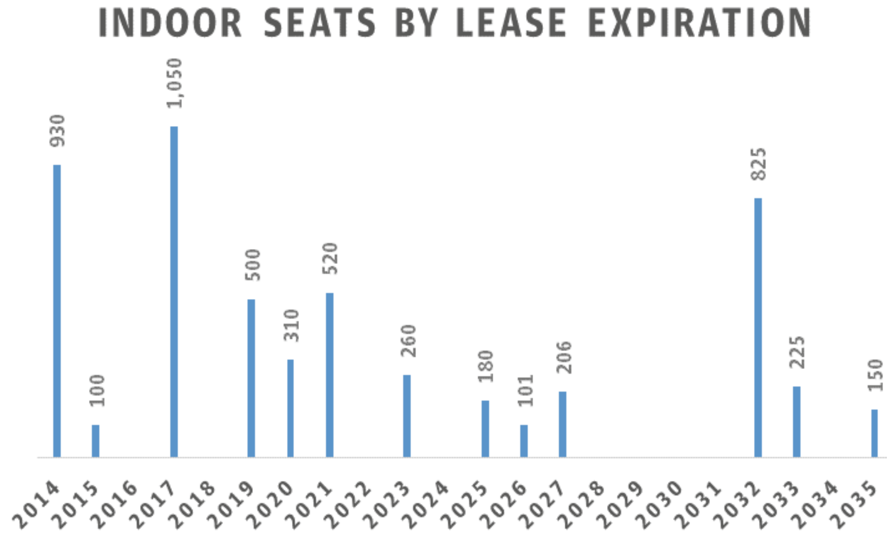
Ark operates restaurants in other landmark locations. Including outdoor seating, it has a 1,000 seat restaurant in Bryant Park (NYC), a 1,000 seat restaurant in Washington Harbour (D.C), and a 400 seat restaurant at the South Street Seaport (NYC).

A good example of the sort of location Ark targets is Union Station. Union Station (D.C.) is one of the busiest train stations in America. About 32 million people pass through Union Station each year. Many of Ark's restaurants are in memorable locations. The restaurants themselves are often visually distinct. Ark describes some as "theatrical". For example, there are a total of 12 restaurants in Union Station. Some are chains like Chipotle and Potbelly. Ark runs only 2 of the 12 restaurants. One is the Center Café. The restaurant is built directly into the main hall of the train station. A huge wood pedestal provides a sort of stage that people can eat on the top of or underneath. In this way, the restaurant can be literally in the center of the main hall of the train station. Unlike the other restaurants in the station, diners feel like they are eating "in the train station" rather than at a restaurant housed in the station. This is typical of many Ark locations. They generally "interact" with the stations, parks, lobbies, waterfronts, etc. where they are located. Ark's larger Union Station restaurant, The Thunder Grill, seats 500 people. Reviews of the restaurant are generally poor (it has been around for 15 years) but even many of the negative reviews mention being at the restaurant several times. All reviewers mention the location and bar staff as being big pluses. Food quality and service are bad. The prices are competitive with other restaurants in the area (which is very expensive). One review sums up the consensus well: "(the Thunder Grill) is practically across the street from the U.S. Capitol and the House and Senate Office Buildings… and their prices reflect the proximity. The food is overpriced and not very good and you have to wait forever to get it." Ark's restaurants vary a lot in terms of reviews. Canyon Road (First Avenue between 76th and 77th Streets in NYC) gets good reviews. It seats just 130 people. The Bryant Park Grill & Café also gets solid reviews. Ark has no quality moat. But competition is limited at each landmark. And many diners come for the view rather than the food.

QUALITY: *Ark is a Portfolio of Individual Concepts Paired with Individual Leases*

There are several different ways to judge the quality of Ark. Quality can mean the quality of the locations. Quality can mean the quality of the actual restaurants at those locations. It can mean the quality of the corporation and its top management apart from the store level quality. The clearest quality stats dealing with profitability are available at the individual restaurant level. It is possible to compare the profitability of different restaurants owned by different public companies by separating out the corporate element and focusing on each store or concept. This makes sense as a tool for evaluating the quality of a restaurant company in the eyes of a possible control buyer. In a merger, the individual restaurants or concepts would generally retain their value while there might be synergies and savings in combining other elements of the corporation. For example, Landry's offered to buy Ark for $22 a share. It would not be cheaper for Landry's to operate the restaurants Ark has in Union Station, the Venetian, or New York – New York. Those operations would have the same quality regardless of their corporate owner. However, Landry's would be able to reduce some of the corporate costs at Ark because Ark is a tiny public company. Landry's is larger and does not have publicly traded shares. Top management and the board would be redundant. The audits would be redundant. And certain costs in the same city might be redundant. However, these synergies are very small compared to those available in many public company mergers. For the most part, Ark's restaurants determine the quality of Ark as a corporation. Each restaurant's quality is determined by the location, the concept, and the management of the specific restaurant. In this way, the quality of Ark as a company is similar to the quality of a portfolio of stocks. Except for capital allocation, there are almost no synergies at Ark. Each restaurant could be equally valuable in another owner's hands. And none of the restaurants are integral to Ark's success as a corporation. They are a portfolio of restaurants that could – if needed – be bought and sold separately. The company has large operations at a few landmarks. The most notable is New York – New York in Las Vegas. However, Ark has shifted its portfolio over time. This includes closing restaurants that were once top contributors to Ark's corporate profitability and opening totally new restaurants that become new leaders. For example, Ark only entered its biggest landmark, New York – New York, in 1997. So, the company has only been in that location for 17 years.

The quality of a successful restaurant is the easiest type of quality to quantify. Ark's store level EBITDA margin is about 17% of sales. Sales are generally double net tangible assets. So, store level EBITDA/Net Tangible Assets is 34%. These figures are based on gross (not depreciated) net tangible assets. Maintenance cap-ex is no more than 5-7% of gross net tangible assets. This is about 2.5% to 4% of sales. That is possibly a slight overstatement of actual maintenance cap-ex. It is based on the actual cash outlays Ark has made. Some of these were intended to create growth. Not all did. These numbers are conservative estimates based on actual past experience. They probably understate the value of a truly successful restaurant because there must be significant variation in the profitability of



69% of Ark's indoor seats have a lease expiration within the next 10 years

specific restaurants in Ark's portfolio even among all of those that are mature and consistently cash flow positive. There is evidence for this in some of Ark's disclosures. Distributions from the Hard Rock partnership suggest it is unusually profitable. It is also likely that New York – New York is more profitable than the Venetian. In general, the larger Ark's operations are at a single site the more likely it seems to be that margins and returns on capital are especially strong. This would be consistent with Ark's strategic shift from smaller restaurants to concentrating on large restaurants at a few key landmarks. Management said this strategic shift was inspired by the actual experience of seeing higher returns on capital at the landmark sites than at the smaller restaurants. Based on the above numbers, pre-tax return on capital at a successful Ark location is likely in the 27% to 29% range. Even assuming a lot of variation at particular restaurants, it seems that many of Ark's existing sites are fully justified on a return on capital basis before taking corporate expenses into account.

Ark's actual results are much lower than these store level results. Since 1998, Ark's gross margin has averaged 74%. It is completely stable. As mentioned earlier, gross margins are less important in the restaurant business than volume. The business is about turning tables rather than getting a particularly strong mix of sales. When Ark has had to cut prices – like in the recession – it has cut protein content (the portion size of meat) to reduce gross costs in line with prices. Ark does not raise prices faster than inflation. And same store sales growth at successful restaurants is usually no greater than inflation. On the other hand, inflation does not cause cost pressure for Ark that it does not pass on to customers. Restaurants generally pass all inflation on to consumers. In fact, food away from home is more stable than grocery store pricing in terms of inflation pressures. So inflation is neither a plus nor minus at Ark. Ark has no pricing power. But faces no inflation it is unable to pass on.

Ark's EBITDA margin since 1998 has averaged 10%. It is stable compared to most companies. Rent and payrolls versus customer traffic account for almost all the variation in EBITDA margin. Cap-ex is about 3% of sales. So the "owner earnings" margin at Ark is about 7%. Sales are usually double gross net tangible assets. So a 7% owner earnings margin translates into a roughly 15% pre-tax return on original cost. Ark rarely uses leverage anymore. So, without using debt, this would bring the after-tax return on equity down to about 10%. The return on a new restaurant at the same location or even in the same city is presumably higher than this 10% after-tax figure. The 10% estimate is just the average across Ark as a corporation. Obviously, Ark is a small public company. The addition of a new restaurant scales well in terms of creating cash flow without adding corporate expense. The reverse is true when a successful restaurant closes.

A successful Ark restaurant can probably generate unleveraged pre-tax returns of about 15% a year for about 20 years. Almost all of the value of Ark is in its existing leases and concepts. A successful location can rarely be repurposed for a new concept. In New York City, Ark failed to re-concept Pinch & S'Mac as Polpette in 2010. At the Venetian, Ark failed to re-concept Venus bar as Vivid bar in 2005. And, also in New York City, Ark failed to re-concept Ernie's as La Rambla in 2003. So, a good location with a poor concept is often a failure for Ark. It is only the combination of a proven location and a proven concept that can be counted on to gush free cash flow.

The quality of Ark's leases is generally very strong. For example, the unsuccessful Clyde Frazier's Wine and Dine is at a location where Ark is paying about $35 per square foot to rent space with a market value closer to $70 per square foot. Ark can stay in the space through 2032. The favorable lease at the Museum of Arts & Design is the only reason Ark opened Robert there. These good leases cut both ways. They are profitable for Ark while the company occupies the space. However, most of Ark's shrinkage as a company has occurred not because of restaurants losing popularity but because of leases that the landlord refuses to re-negotiate with Ark at anywhere near similar terms at the end of the lease. The lack of equally attractive leases is the biggest constraint on Ark's growth.

CAPITAL ALLOCATION: *Ark Will Use its Free Cash Flow to Buy Restaurants and Pay Dividends*

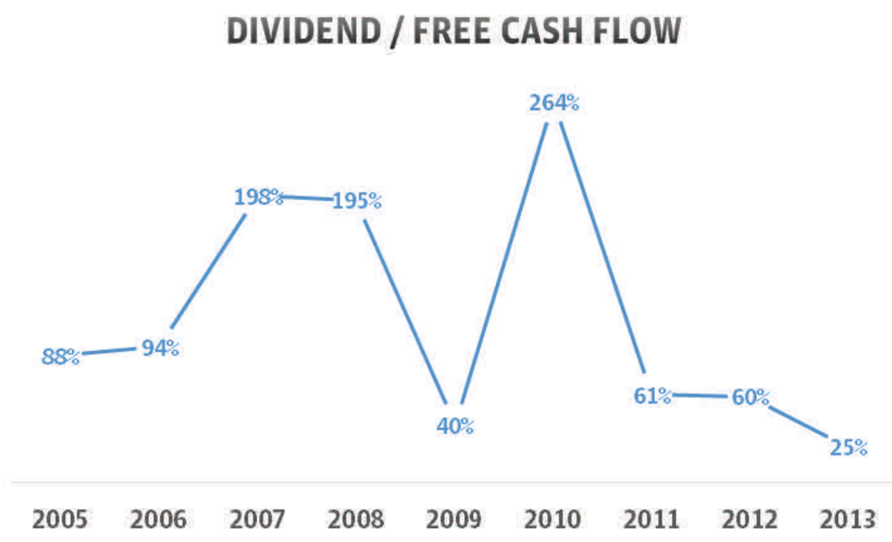
Capital allocation is especially important at Ark because the company does not operate a single concept. In fact, only a couple of Ark's concepts (such as Gallagher's) use even two locations. Most of Ark's concepts are limited to one location. This makes reinvestment in the business a discretionary decision at the very top of the company. There is no natural reinvestment possibility created by an annual plan of a certain amount of new store growth at an existing concept. Ark does not need to retain its earnings to add more stores. Instead, Ark's management treats each restaurant as part of a portfolio. Almost 70% of Ark's indoor seats are located at restaurants where the lease will expire within the next 10 years. Ark may replace some or all of these seats with new restaurants in new locations. Ark may sign new leases at the same locations. But these are all capital allocation decisions. They are not automatic decisions. They are something the company's founder and CEO, Michael Weinstein, is always involved in. Weinstein talks a lot about capital allocation.

A 1994 article about Ark's acquisitions mentioned: "Bob Towers, Ark's chief operating officer, will only concede that the company usually pays no more than three times the adjusted pre-tax cash flows when it buys a restaurant." Michael Weinstein often uses the language of a value investor when discussing capital allocation. In 2008, he said: "And from my point of view, I don't want to talk about Warren Buffett's big fat softball coming across the plate, and use his words, but everything has to be going in our direction. There is no negotiation with us right now. We're prepared to negotiate. We see EBITDA and we give a price. If the leases are correct, if the locations are correct, if the history of the business is correct, and if there are any flaws in any of that, we're not going to budge because we think perfect deals will come our way. So it is a very measured approach."

Ark has returned a lot of capital to shareholders. The company had $30 million in debt back in 2000. It paid that debt down to nothing by 2004. Since then, Ark has paid dividends. The company paid $5 million in 2005 and 2006. This was roughly equal to free cash flow. In 2007, Ark paid a special dividend to avoid building up cash after making a $14 million sale of two restaurants (Lutece and Tsunami) to the Venetian Casino in Las Vegas. So, in 2007, Ark paid out $16 million in dividends despite free cash flow of just $8 million. When the crisis hit, Ark cut its dividend sharply. The dividend was stopped temporarily in 2009. But this did not last even one full year. Ark ended up paying out $6 million in 2008, $2 million in 2009, $7 million in 2010, $3 million in 2011, and $4 million in 2012. In recent years, the company has paid out less in dividends than it generated in free cash flow. Also, Ark's recent free cash flow has probably been lower than its cash earnings from the same restaurants would be in normal times. Restaurants generally and Las Vegas specifically did not perform well relative to the full cycle demand for their seats during The Great Recession. Some weather problems – especially Hurricane Sandy and a bad winter this year – hurt Ark's results on the east coast. Ark has some outdoor seating in Washington Harbour and Bryant Park (D.C. and New York City respectively) that is only used when weather permits. These factors combined with the losses at Clyde Frazier's Wine and Dine reduced free cash flow relative to normal levels. For these reasons, it is very likely that unless Ark finds enough restaurants to buy, it will pay out higher dividends per share in future years than it has at any point since 2007. Over the last 10 years, Ark's free cash flow averaged $7.4 million. Ark has not generally grown sales over the last 15 years. New restaurants have been added while other leases have expired. There have been successes and failures. There have also been some sales like those made to the Venetian described above and some purchases of existing restaurants. However, a no growth assessment of the last 10 years of actual results, is probably a fairly accurate estimate of Ark's free cash flow generating ability. With 3.26 million shares outstanding, it is likely Ark could pay out $2 a share if management had no other uses for owner earnings. Ark has shown no preference to hoard cash. Management likes to grow the company. But when there were no high return on capital opportunities in Ark's circle of competence (large restaurants in landmark locations especially in cities like Las Vegas, D.C., New York, and Boston – where Ark is already present), the company has paid out all the excess cash. For these reasons, it is likely Ark will eventually pay out a dividend of around $2 a share. At the current price, this would be a 9% yield. Ark's stock price has stayed closely anchored to Landry's $22 offer. This likely means investors do not believe Ark will actually average a $2 dividend over the long-term future. Some may believe the current dividend is normal. Stocks rarely trade at a 9% dividend yield. Since Ark initiated its dividend, the stock's yield has been around 5% in normal times.

Ark sometimes buys back stock. But investors should not count on this. Weinstein explained why in 2008: "When you buy back…the stock, you're shrinking capitalization, but you're not adding good businesses… in the end, what you really want to own, we believe, is good businesses. And we think we can find those businesses. We're very comfortable that this strategy is the better strategy and we're going to add to our portfolio of restaurants with good leases, with good long (histories) of solid sales and solid productivity."

Ark is more likely to buy existing restaurants than build new ones. In 2008, Weinstein laid out the criteria Ark still uses today: "So EBITDA is the criteria, and the safety and reliability of that EBITDA is also the criteria. There are a lot of wonderful, mundane restaurants that aren't in the press and don't have a famous chef that knock out consistent earnings every year with good leases. Those are what we want…We think purchasing assets is…the primary thing we will be doing as



Since starting a dividend in 2005, Ark has paid out all its free cash flow

opposed to constructing…Most of the locations we have today, we built, and while we've done some purchasing in the past, the majority of our operations were built by us."

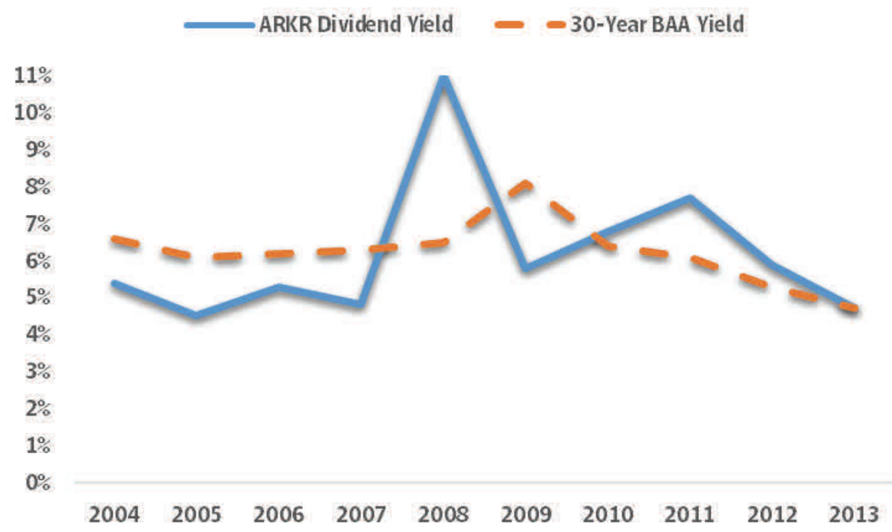
Ark's growth has been constrained by management's focus on return on capital. If Ark fails to get the right locations at the right rents, it fails to grow. Leases are critical to the company's success. And management's value investing approach to leases limits the number of pitches Ark swings at. The company has walked away from a lot of deals. They have also paid out a lot of earnings rather than retaining them. Ark suspended its dividend during the crisis in part to try to find good restaurants to buy on the cheap. That did not happen. There were fewer distressed sales than management anticipated. Regardless of economic environment, Ark tends to focus on good locations with good leases: "You know, we are in the capital allocation business here. We're going to put capital into good venues where we have strong tenant leases. We don't have to hit home runs to do well…I am not in the business of trying to guess what sales are. I am in the business of trying to make good, solid investment that if we hit singles it is good for our shareholders. I don't want to have to hit homeruns." Clearly, investors in Ark's stock should expect free cash flow to be used primarily for the purchase of existing restaurants and then secondarily for the payment of cash dividends.

VALUE: *Ark is Capable of Paying $2 a Share in Dividends Instead of the $1 It Now Pays*

Ark's stock price is driven by two backward looking factors: the $1 a share dividend and Landry's $22 a share buyout offer. The stock is illiquid. And Ark does not get a lot of publicity with investors. Ark's CEO, Michael Weinstein, does do earnings calls that explain the company's results. Sometimes, there are no questions from analysts on these calls. He also writes annual letters. They are candid but short. They usually run one to two pages. Ark also releases financial results in EBITDA terms rather than just using GAAP. As a result, they must also include a reconciliation of non-GAAP and GAAP numbers. This leads Ark to discuss EBITDA and adjusted EBITDA in greater detail than some tiny companies do. Management often explains what specific events (weather, construction, poor or strong same store sales at each site, the economy of each city, a bad opening of a new concept, etc.) drives the year over year change in results. Despite these disclosures, there is not a lot of evidence that the stock price reflects anticipated future results.

Instead, the strongest determining factors seem to be purely reactive. Since 2004, Ark's dividend has probably been the main driver of its stock price. The yield is fairly stable. It was 5.4% in 2004, 4.5% in 2005, 5.3% in 2006, and 4.8% in 2007. In those same years, Moody's 30-year BAA yield was generally around 6% to 6.5%. Long-term bond yields may be an anchor for what constitutes the upper limit of a reasonable dividend yield. When 30-year BAA yields are at 10%, a dividend yield of 7% might seem reasonable. However, when bond yield are at 6%, a dividend yield of 7% would be seen as unreasonably high for any stock with durable earning power.

When Ark started its dividend payments in 2004, the company was debt free. Ark's EBITDA has been quite stable since 1998. It ranged from $7 million to $14 million with a median and mean of $11 million. The variation in EBITDA was low compared to many public companies. The restaurant industry is somewhat cyclical since traffic to full service restaurants and landmark restaurants especially often declines during periods where consumers are cash strapped and pessimistic. However, the restaurant industry is not especially sensitive to the economy except during periods of real consumer discomfort. External events are only notable in Ark's past record at two points. One, the September 11th attacks. The attacks completely devastated Ark's business for about a month. Ark operated restaurants in New York City and Washington D.C. (where the attacks occurred). And Ark's other locations all depended on customers flying to the landmark location. For example, airline travel is critical to Las Vegas's economy. September 11th had by far the greatest negative influence on Ark's results of any outside event. The attack was unprecedented. And no event of similar scope has happened in the U.S. since then. The second event – also of unusual scope compared to previous events – was the 2008 financial crisis. This hurt certain markets. New York and Las Vegas were especially hurt. More



Ark is priced on its current dividend instead of its likely future dividend

importantly for Ark's stock price, the stock market as a whole dropped. This had a predictable result for Ark's dividend yield. The stock's dividend yield shot up to 11%. At the time, Moody's 30-Year BAA corporate bond yields peaked at 9.25%. While the relationship between Ark's dividend yield and long-term bond yields is far from perfect – Ark traded at a premium before the crisis and a discount to BAA yields during the crisis – it is strong. Ark's dividend and the prices of other assets (bond yields on debt and dividend yields on stocks) seem to determine Ark's stock price. The stock's dividend yield is almost always higher than that on stocks generally but lower than that on corporate bonds. In other words, Ark is usually priced as a high dividend yield stock.

The market reacted to one other event besides dividend announcements. Since Landry's $22 a share offer, Ark's stock price has been pretty sticky at around that level. This does not make a lot of sense. Ark is a controlled company. And Ark rejected Landry's offer. Landry's did not pursue any sort of takeover attempt – which would be completely doomed to fail without Michael Weinstein's approval – after Ark rejected the $22 a share bid. The only important influence Landry's offer should have over Ark's stock price is the confirmation that an informed potential buyer in the same business was willing to pay $22 a share.

Ark has paid out wildly different proportions of its free cash flow as dividends. For the last 3 years, Ark's dividend payout has been low relative to what the company is capable of. Ark has $5 million of net cash. Normal EBITDA is about $14.7 million. This takes two adjustments into account. One, the losses at Clyde's Wine and Dine will either stop or the restaurant will be closed and the property leased at a profit for Ark. Two, the non-controlling interests in the Hard Rock and Ark Connecticut (Foxwoods) partnerships do not actually belong to Ark. These two factors essentially offset. Ark has spent $3.5 million a year on cap-ex over the last 12 years. Sales increased slightly (1% a year). So $3.5 million a year can be used as the estimate of cap-ex. That leaves Ark with pre-tax owner earnings of $11.2 million. At a 40% tax rate (Ark must pay both Federal and State taxes) this $11.2 million would translate into $6.7 million after-tax. Ark has $5 million on hand and no debt. Ark's leases are strong. The Clyde's location is underutilized. And the company does not hoard cash. For these reasons, Ark will tend to pay out all of its free cash flow that is not used to buy new restaurants. It is important to remember that maintenance cap-ex does not refer to actual required maintenance on Ark's existing locations. The $3.5 million cash outflow is an estimate of the amount

Ark would need to spend each year to buy, build, or renovate restaurants to keep sales and free cash flow steady in future years. So up to $3.5 million a year of acquisition spending is potentially non-growth and part of this free cash flow estimate. The best estimate of future dividends at Ark is the $6.7 million in after-tax owner earnings divided by the 3.26 million shares now outstanding. This puts estimated future dividends at $2.06 a share. Right now, Ark is only paying a regular dividend of 25 cents a quarter ($1 a year). So, a backward looking dividend yield assessment suggests the current stock price gives the stock a 4.5% dividend yield. However, the fact that Ark is paying only half of what it could be – and likely one day will be –in dividends per share, means the price to expected future dividends is set to yield 9% right now.

The market has never priced Ark at normal EV/EBITDA ratios. Before Ark started paying a dividend, the stock sometimes traded at an EV/EBITDA ratio of 3. Once the dividend was implemented, this ratio leapt to 7 in 2004, 9.5 in 2005, 9.2 in 2006, and 10.3 in 2007. The same stock was valued about 3.5 times higher in 2007 than before 2003, simply because it paid a large dividend. When Ark cut its dividend, the stock's EV/EBITDA collapsed. It went from 10.6 in 2009 to 8.9 in 2010, 5.8 in 2011, and 4.2 in 2012. Meanwhile, the dividend yield was actually identical in 2009 and 2012. It is at a normal level of 4.7% right now. However, today's stock price assumes Ark's $1 a share dividend is normal. It is not. Over the next 10 years, Ark will average a dividend closer to $2 a share than $1 a share. The stock price does not reflect this. When the dividend is increased, it will. It is possible that a doubling of Ark's dividend will eventually lead to a doubling of Ark's stock price.

GROWTH: *Ark Should Be Analyzed as a Stable, No Growth Business*

Ark's growth prospects are very limited. The company includes this statement in every 10-K: "Our restaurants generally do not achieve substantial increases in revenue from year to year, which we consider to be typical of the restaurant industry. To achieve significant increases in revenue or to replace revenue of restaurants that lose customer favor or which close because of lease expirations or other reasons, we would have to open additional restaurant facilities or expand existing restaurants. There can be no assurance that a restaurant will be successful after it is opened, particularly since in many instances we do not operate our new restaurants under a trade name currently used by us, thereby requiring new restaurants to establish their own identity" The company has always been very clear about the fact that its existing restaurants do not typically increase sales after they have been successfully established. Only new restaurants can do this. Ark does spend money building and buying new restaurants. They have not stopped doing this. For example, Ark paid $7.5 million to buy the Rustic Inn Crab House in Florida. The restaurant has been in Fort Lauderdale for about 50 years. It is one of Ark's largest recent purchases. Ark has invested other money in building, buying, or increasing its interest in restaurants at several points in the last few years.

Clyde's Wine and Dine in New York City required a $7 million investment. The landlord put in $1.8 million. Ark put in the other $5.2 million. This is a 10,000 square foot and 250 seat restaurant with both a bar and a dining area. The bar has been popular. The dining area has not. Like many of Ark's locations, a lot of money went into the design of Clyde's. The restaurant includes an indoor basketball court. This review is typical of customer reaction to the décor: "I especially loved the decor. Clyde's iconic suits hang from the ceiling in an eye-catching installation and in the rear lounge as the table top designs. The half-court basketball private area made me think of every young sports fan I'd like to treat to a special time out and even makes dunking look easy. As was pointed out by my lovely boyfriend, the cocktails are named after Mr. Frazier's colorful announcement vocabulary." Walt Frazier often appears at the restaurant. His personality is a selling point because he was a local (Knicks) basketball star and later an announcer in the same New York City market. The restaurant has gotten positive feedback from customers relative to other successful Ark restaurants. The online reviews are actually more positive than at Ark's D.C. restaurants. However, the concept has not played out as planned.

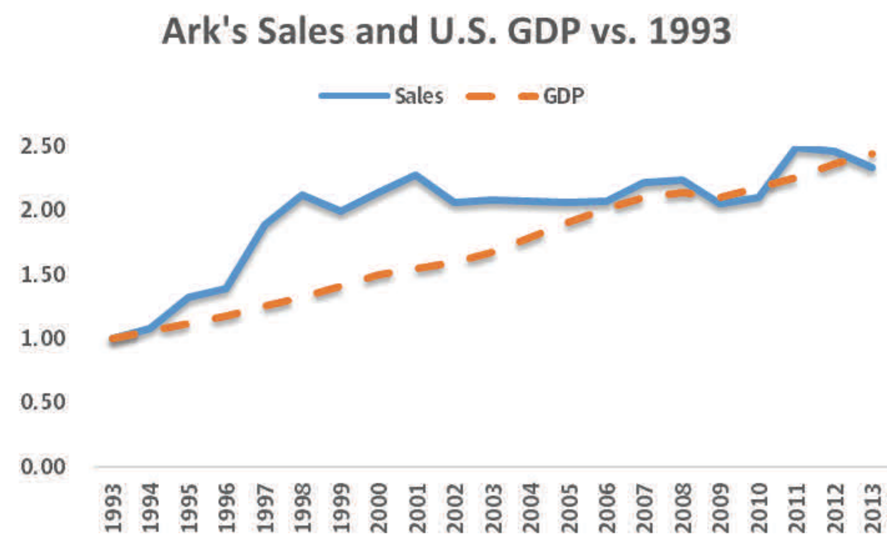
Here is Michael Weinstein describing Clyde's Wine and Dine before it opened: "It's a 10,000 square foot facility. We have the correct rent deal. Our deal with him is very fair. There has been a lot of buzz about the restaurant. It was designed by Thom Mayne who won the Pritzker Awards several years ago. We had used Thom many, many years back on the Venetian. I think what he's done is extraordinary. It's unlike anything that I think people will expect. It's just extraordinary, extraordinary design. It is an upcoming area of New York, which is midtown west. There are about 9,000 condo units that have been built in the last couple years... There is extraordinary expansion in construction going on there right now. In the next couple of years, I think there will be almost 15,000 (to) 16,000 units. The High Line is going to be extended up very close to the restaurant. The Javits center is a block away. So, we think that the demographics are very, very strong. The Garden is not so far away. Madison Square Garden. And he (Walt) is an icon in New York. So, we think we got a very good chance to have significant success there."

So far, Ark has not had success. Those comments were from Michael Weinstein at the start of 2012. Six months later, he gave a long answer explaining what he saw was wrong with Clyde's: "I want to talk about Clyde's.

And this has been a dramatic disappointment for us so far. It's a restaurant which, from the point of view of the lease we did, the visibility we thought we had created, the menu – which has gotten great reviews, there's Clyde and his participation, which has been spectacular – he's there every night he is in New York. We really thought we had something that would perform very well. It has not. We think there is a problem in terms of anchoring this in people's heads about what it is. We didn't intend to be a sports bar. We intended to be (a) really fine restaurant, certainly with a big area to the bar and the lounge, and a lot of TV sets, but we thought we had done this at a very high level. The truth of the matter is, I think people want it to a sports bar. And they are ignoring the dining room. The bar is busy. The lounge is doing what it's supposed to be doing. But they are ignoring the dining room. And I think we have to change the menu dramatically to recognize that…we're not doing what the public wants us to do." This is consistent with the online reviews of Clyde's. Several describe it as a better version of a Hooter's. This is not the positioning Ark was originally aiming for.

In 2013, Weinstein first described the possibility of assigning the lease: "We have a terrific rent with 20 years left…there's certainly extraordinary value in the lease if we wanted to sell it. We acquired that lease in 2009 at $35 a foot. A lease up the block for the same amount of space, 1 block south of us, just went to $75 a foot. So we are controlling an assignable lease that we think has value, but we're not looking to assign it. We think this is going to be successful. It's going to take some more time, but we're getting there."

Weinstein also said he told people: "I don't think I've worked harder on a restaurant in my whole life because we believe in it so much." Clyde's is a good example of the kind of difficulties Ark has when trying to expand its business.



Ark's sales matched GDP growth of 4.5% a year over the last 20 years

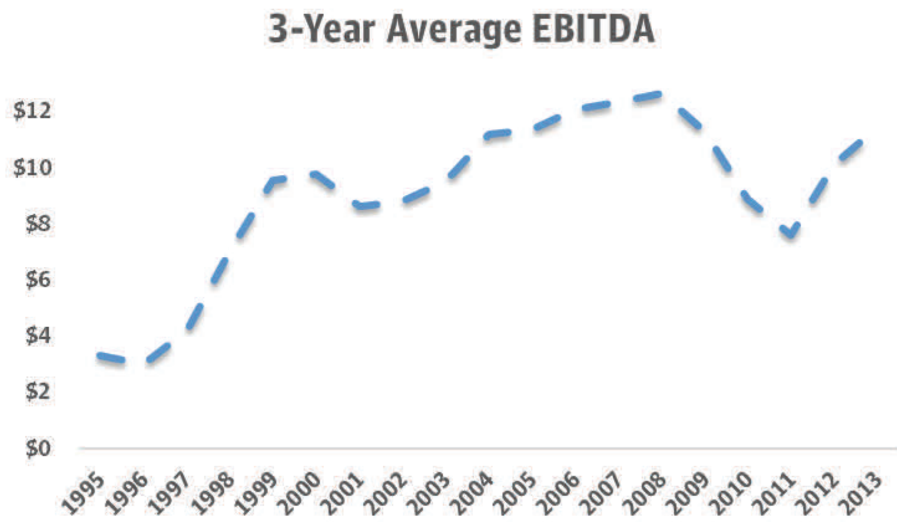
Ark has several other new investments that may generate lasting business. Ark is now in the Meadowlands and Basketball City (Pier 36). Ark has a small restaurant at Basketball City. But they did the deal – like at The Meadowlands – for the exclusive catering rights for the whole facility. Ark also plans to run a café at the new Museum for African Art (the new site will be near Central Park). It is a 300 seat outdoor café. Exclusive catering rights were a likely attraction to this deal as well. Ark already runs a museum café at the Museum of Arts & Design called Robert.

Ark's growth will be limited by lease expirations. A total of 550 seats (300 in the Venetian food court, 150 at the Rialto Deli, and 100 at V-Bar) expire in the Venetian over the next two years. All of Ark's restaurants with leases expiring in the next couple years contribute about 12% of the company's EBITDA. These expirations are meaningful. However, Las Vegas contributes 40% of sales and EBITDA from Las Vegas was $4 million lower in 2011 and 2012 than it had been before the crisis. So, a full recovery to pre-crisis levels in Las Vegas could offset a lot of lease expirations. Investors should expect Ark will need to use about $3.5 million a year in capital spending to maintain its current earning power. Growth is unlikely. However, sales decay can be avoided by buying existing restaurants or building new ones. Investors should analyze Ark as a stable, no-growth investment.

MISJUDGMENT: *Will Ark Maintain its EBITDA While Paying Out 100% of Free Cash Flow?*

The biggest risk of misjudging Ark as a stock is the risk of assuming free cash flow will be more durable than it turns out to be. This can happen in a few ways. One, an investor could assume Ark's maintenance cap-ex needs are lower than they actually are. Perhaps Ark's restaurants performed better over the last 10-20 years than they will over the next 10 years. If this was especially true of successes with new openings, an investor could underestimate how much free cash flow Ark will need to set aside to maintain its current earning power. The figure used throughout this issue is $3.5 million a year. About 70% of Ark's indoor seats (but fewer of its total seats and almost certainly less of its EBITDA) will face lease expirations during the next 10 years. Ark can sign new leases at the same locations, can buy existing restaurants, or can build new restaurants to replace this revenue as the leases expire. All of this costs money. The $3.5 million cap-ex assumption used in this issue suggests that Ark will need to spend $35 million to buy or build restaurants just to maintain the same level of free cash flow it has now. Since 1993, Ark managed to grow sales as fast as U.S. GDP. The rate of growth in both figures over the last 20 years was 4.5% a year. Ark had less success growing sales over the full period from 2003 through today. However, Ark did have some success growing sales up until the crisis. The percentage decline in EBITDA was greater than the percentage decline in sales. And Las Vegas was the main culprit. For this reason, part of the question of whether Ark has invested enough in the past to maintain steady levels of free cash flow and just how much Ark will need to spend in the future depends on how "normal" the restaurant environment in Las Vegas is. Las Vegas now accounts for 40% of Ark's sales. If Las Vegas is at all below potential and will recover further in future years, Ark should have a much easier time maintaining free cash flow while spending just $3.5 million a year in cap-ex.

Another factor to consider is how much Ark will have to put up in its own money versus how much other partners will put up. In recent years, Ark has been able to open bigger restaurants with less of its own money. For example, at Clyde's Wine and Dine Ark put in just $5.2 million of a total investment of $7 million. The landlord put in the other $1.8 million. Furthermore, the capitalized value of the right to assign the 20 years remaining on Ark's lease is close to $3.2 million. If Ark could rent the location for the same rent per square foot paid for a property one block away, Ark would generate $400,000 a year in rental income above the rental expense on that property. This would continue for 20 years. The value of $400,000 a year collected for the next 20 years is significant. This means that the actual value risked by Ark on the project may not really have been as high as $5.2 million. And the value given up by the landlord may have been much higher than the $1.8 million contributed to developing the property. The landlord is certainly collecting less rent from Ark than the market in New York City would provide today. And the landlord will not be able to negotiate a more favorable lease for another 20 years.



EBITDA fell after the September 11th attacks and the 2008 Financial Crisis

In this way, the lease protects some of Ark's investment in Clyde's Wine and Dine and represents an additional investment by the landlord.

It makes sense to assume Ark's future will resemble its past. Ark's CEO founded the company and has spent an entire career (39 years) running it. The strategy the company is using is similar to what Ark has been doing since the late 1990s, and almost identical to what Ark has done since September 11th. There has been very little shift in strategy over the last 10 years. Most changes in the company's results have been caused by outside factors. Ark itself has not changed course for at least the last 10 years. So there is a long-term record to look at. There is also the balance sheet to consider. Ark once had debt. The company has not had any meaningful net debt for more than a decade. However, Ark does not hoard cash. The company could – if needed – increase leverage for a particularly attractive deal and then pay the debt down later. The balance sheet offers further support for the idea that whatever cash Ark does not reinvest in buying and building restaurants, it will pay out in cash. There is no need to strengthen the balance sheet further. And it could survive some weakening. This supports the idea that Ark will eventually pay out a dividend of $2 a share or do some big deals that will grow sales.

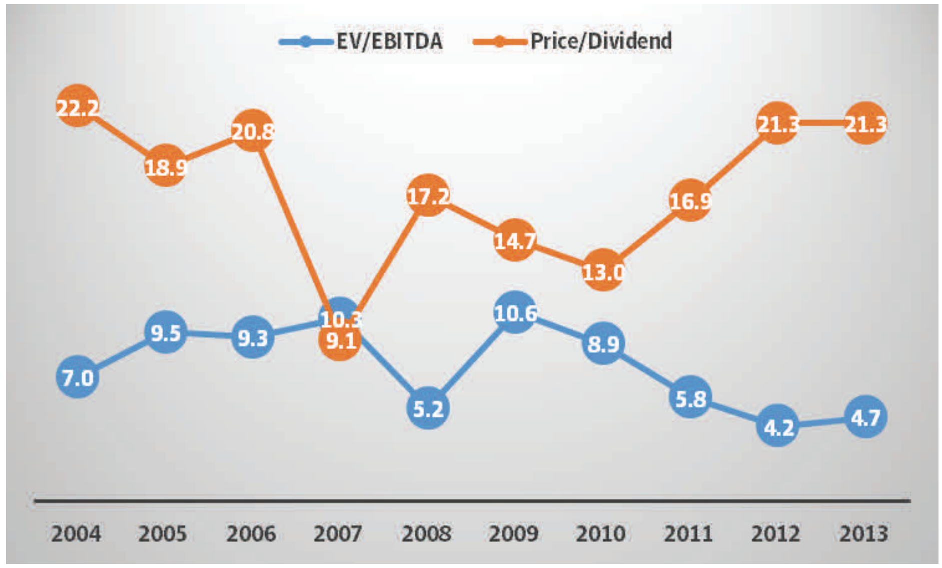
It is possible to misjudge Ark's future in some way and yet not be wrong about buying the stock. Ark can repay an investor in 3 ways. It can pay dividends that are very high relative today's purchase price. It can grow its sales, EBITDA, and free cash flow over time. Or it can do some combination of both. How much cash Ark retains versus how much Ark pays out is an uncertainty but not necessarily a risk. It becomes a risk only to the extent Ark retains cash and does not get a good return on the cash retained. Over the last 20 years, Ark retained earnings for the first decade and paid out all earnings for the second decade. Ark achieved most of its growth (8% a year) from 1993 through 2001. This was the period of greatest reinvestment by Ark. After the September 11th attacks, Ark faced a financial crunch that scared management. The company quickly paid down debt. And a couple years later, it started paying out a dividend. Ark has grown very little (about 0.2% a year) since 2001. However, the company first eliminated all debt and then paid out all free cash flow as dividends. So the period where dividends were not paid was a period of 8% a year growth. And the period where growth did not happen was the period where all free cash flow was paid out in dividends. Ark never retained earnings and failed to grow.

By being opportunistic, Ark's management chose to grow the company from 1993 through 2001 and chose not to grow the company from 2001 through 2013. There is a constant tension between the desire to grow and to earn good returns on capital. An investor does not need to know which course Ark will take as long as the combination of dividend yield and growth adds up to a good return on today's stock price.

The biggest uncertainty for a long-term investor in Ark is the presence of Michael Weinstein. He started Ark's first restaurant in 1975. Weinstein is now 70. At some point in the next ten years, he may decide to retire. That is a long-term negative for Ark, because Weinstein's capital allocation has been excellent. However, it may be a short-term positive for the company, because Weinstein's control of Ark is the biggest obstacle to an acquisition. Landry's offered $22 a share to buy the company. And Ark trades at a discount to the EV/EBITDA (and especially EV/Peak EBITDA) at which public restaurant companies are usually acquired. If Weinstein decided to leave Ark, shareholders might be rewarded with a takeover. The best future for long-term shareholders would be Weinstein staying and continuing Ark's present strategy as an independent company. However, Weinstein's retirement might improve the odds of a takeover at a price higher than today's $22 a share. So the possibility that Weinstein will eventually retire is an uncertainty but not necessarily a risk.

CONCLUSION: *Ark Shares Offer a 5% Dividend Yield and 50% Upside*

An investment in Ark has less risk than uncertainty. Ark does not operate the same concept at multiple locations around the country. The company has leases that will expire. Over the next 10 years, most of Ark's seats will face lease expiration. Ark will sign new leases on some of the same locations. But it will fail to come to



Ark's low dividend payout distracts from its historically cheap EV/EBITDA

terms with the landlord on other leases. Some of these restaurants will be closed. Other restaurants will be opened. Ark has the free cash flow to buy new restaurants. Even the estimate of maintenance cap-ex used in this issue does not focus solely on existing restaurants. The estimate of $3.5 million a year in capital spending to maintain current earnings assumes that some of that money will be used to either build new restaurants or buy existing restaurants. Ark has done both. In the past, Ark built many more restaurants than it bought. But, management has said that Ark is looking to buy more restaurants now than it had in the past. One of Ark's most recent purchases is the $7.5 million spent to buy the Rustic Inn Crabhouse in Fort Lauderdale. However, Ark has also built restaurants recently. Within the last few years, Ark invested a total of $7 million in Clyde's Wine and Dine ($5.2 million in an opening investment and $1.8 million in losses during the restaurant's first year). So an investor can not know if Ark will pay out most cash as dividends over the next 10 years, mostly buy existing restaurants, or mostly build new restaurants. To the extent that Michael Weinstein's capital allocation decisions are uncertain, the way an investor will make money in Ark is also uncertain.

It is easy to overstate this point. For a long-term investor, the way a stock rewards its holder is often uncertain. Uncertainty about how a shareholder gets paid is often confused with risk. Likewise, uncertainty about exactly when a stockholders gets paid is confused with risk. Ark's value will eventually be determined by the dividend it pays. This is obvious from Ark's stock price performance over the last 10-15 years. The company has often traded at an inappropriate EV/EBITDA ratio. At times, Ark has traded between 3 and 5 times EBITDA. This is extraordinarily low for a publicly traded company with a portfolio of restaurants in different cities. In fact, negotiated transactions for individual, privately held restaurants are often done at 3 to 5 times EBITDA. Even when Ark was at its most demanding in terms of getting the best prices for its acquisitions, management never suggested deals could be done for less than 3 times EBITDA. That was always considered a very low price for an established, successful restaurant. Publicly traded portfolios made up of such individual locations almost always trade for significant premiums over private deals for a single site. That has not always been the case for Ark. When Ark has paid most of its free cash flow out in dividends, the stock has been priced at a large premium to what Ark itself would pay to buy an established restaurant. At times, like 2007, Ark has even traded right in line with faster growing public restaurant companies that rely on a single concept. But when Ark has paid out a low ratio of dividends to free cash flow, the stock has been valued at a very low multiple of EV/EBITDA. In fact, there is no evidence the market actually values Ark on its free cash flow. Instead, the market uses the dividend. This is a mistake. A long-term shareholder does not need to know what Ark's dividend is today. He needs to know what Ark's dividend will be when he sells the stock. For a truly long-term (at least 5 year) holder of Ark stock, that dividend is more likely to be $2 a share when he sells the stock than the $1 dividend paid out today.

Lease expirations are a major concern for Ark. However, Ark does not depend on any one concept. And many restaurants turn out to have a lifespan during which they thrive in popularity and later mature and eventually die off. For example, Bennigan's was founded in almost the exact same year (1976) as Ark's first restaurant. That concept grew to such a size that it still had 288 locations (half company owned and half franchised) when it filed for Chapter 7 bankruptcy in 2008. A Chapter 7 bankruptcy involves a liquidation (rather than reorganization) of the business. The Bennigan's concept is now essentially extinct. The entire period of boom and bust took less than 40 years. The average lease term for an Ark restaurant is about 20 years. Of course, the popularity of a landmark location does not last forever either. However, some – like Union Station and Central Park – are pretty much permanent sources of traffic. Even when one site loses popularity – like a specific hotel or casino – a cluster of activity can live on attracting people to an area even as some of the sites change. Ark draws significant numbers of visitors to its locations based on the wider area (like the Las Vegas Strip) it is in rather than just people interested in a specific site (like the New York-New York Casino). For example, Ark operates Gallagher's in New York-New York. The New York – New York Casino and Hotel itself is a major attraction. It cost $460 million to build in 1997. The hotel has over 2,000 rooms. Despite Gallagher's actually being in New York – New York, most patrons of the restaurant do not stay in one of those 2,000 rooms. In 2011, Michael Weinstein explained how Ark's restaurants draw from more than just the hotel or casino they are inside: "It's very hard for us to figure out who our customer is in each one of these units. We run many operations for instance in New York – New York. But let me tell you about one of them, which I think is relatively important and we shouldn't lose sight of ever. Gallagher's is a 220-seat restaurant that does about $14 million in revenue, a little bit more than that. It does not do it primarily with a New York – New York customer. A New York – New York customer is generally staying there right now at $89 a night, or $119 on weekends, and Gallagher's is a pretty hefty checkout. So we a pulling from all over the strip."

It is also worth noting that in 2011, Gallagher's at New York-New York, generated more than 10% of Ark's sales on less than 4% of Ark's seats. That restaurant's lease does not expire until 2023. Lease expirations described in terms of seats can be helpful. But, each seat varies in terms of how much revenue it generates and how profitable it is. So it is not possible to conclude that if 10% of the company's seats expire in a certain year that 10% of EBITDA will also expire. The situation is more complicated than that. Underperforming restaurants are more likely to be closed. Ark has decided not to sign a new lease at some profitable locations, because the rent increase would be too great. However, most restaurants Ark closed were shut down for other reasons. They did not fit the company's new strategy of big restaurants at landmark locations or they generated operating losses or their sales were too weak – and often weakening – to justify renting the same space at a higher price in the future. In most cases, Ark will be able to either rent the same location in the future or the restaurant will generate enough free cash flow to finance the purchase of a different restaurant that can replace the lost EBITDA. For this reason, it is appropriate to value Ark as a high dividend yield stock. The company should be capable of paying $2 a share in dividends in the future. In normal times, a 6% dividend yield is considered high. That would value Ark at $33 a share.

Ark Restaurants (NASDAQ: ARKR)
Appraisal: $35.89

Margin of Safety: 40%

Owner Earnings	(in mil-
Non-controlling Interest Distri-	
2012 distribution to 50%	**$2.30**
Future distribution to 35.61% interest	**$1.64**
Normal EBITTDA	
2012 EBITDA	**$14.5**
+ Operating loss at Clyde's	**$1.8**
- Future Non-controlling Interest Distribution	**$1.6**
= Normal EBITDA	**$14.7**
Pre-tax Owner Earnings	
Normal EBITDA	**$14.7**
- Maintenance CapEx	**$3.5**
= Pre-tax Owner Earnings	**$11.2**

Business Value

Ark's business value is $112 million.

- Pre-tax owner earnings are $11.2 million
- Fair multiple = 10x pre-tax owner earnings
- $11.2 million * 10 = $112 million

Fair Multiple

Ark's business is worth at least 10x pre-tax owner earnings

- Quan thinks: "Ark operates above average restaurants. It's worth at least 10 times pre-tax owner earnings"

Share Value

Ark's stock is worth $35.89 a share

- Business value is $112 million
- Net cash is $5 million
- Debt: $3.7 million
- Cash: $8.7 million
- $8.7 million – $3.7 = $5 million
- Equity value is $117 million
- $112 million + $5 million = $117 million
- Equity Value = $35.89/share
- 3.26 million outstanding shares
- $117 million / 3.26 million = $35.89

Margin of Safety

Ark's stock has a 40% margin of safety.

- Business Value = $112 million
- Enterprise Value = $67 million
- Discount = $45 million ($112 million - $67 million)
- Margin of Safety = 40% ($45 million / $112 million)

	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Bravo Brio	0.75	1.00	7.20	13.57	5.37
Darden Restaurants	1.06	4.79	8.69	13.98	10.94
Kona Grill	1.62	2.23	14.04	29.12	17.13
Del Frisco	2.30	3.30	16.24	22.97	17.24
Chuy's Holdings	3.21	4.41	27.03	42.61	32.46
Minimum	0.75	1.00	7.20	13.57	5.37
Maximum	3.21	4.79	27.03	42.61	32.46
Median	1.62	3.30	14.04	22.97	17.13
Mean	1.79	3.15	14.64	24.45	16.63
Standard Deviation	0.89	1.40	7.03	10.79	9.06
Variation	50%	44%	48%	44%	54%
Ark Restaurants (Market)	0.51	0.68	6.06	10.10	5.21
Ark Restaurants (Appraisal)	0.98	1.31	11.63	19.38	10.00

ABOUT THE TEAM

Geoff Gannon, Writer

Geoff is a writer, blogger, podcaster, and interviewer. He has written hundreds of articles for Seeking Alpha and GuruFocus. He hosted the Gannon On Investing Podcast, The Investor Questions Podcast, and The Investor Questions Podcast Interview Series. He wrote the Gannon On Investing newsletter in 2006 and two GuruFocus newsletters from 2010-2012. In 2013, he co-founded The Avid Hog (the predecessor to Singular Diligence) with Quan Hoang. Geoff has been blogging at Gannon On Investing since 2005.

Quan Hoang, Analyst

Quan is a stock analyst. Quan won first prize in Vietnam's National Olympiad in Informatics in 2006. He graduated from Manhattanville College in 2012 with a B.A. in finance and a minor in math. In 2013, Quan co-founded The Avid Hog (the predecessor to Singular Diligence) with Geoff Gannon.

Tobias Carlisle, Publisher

Tobias Carlisle is the founder and managing director of Eyquem Investment Management LLC, and serves as portfolio manager of the Eyquem Fund LP and the separately managed accounts.

He is best known as the author of the well regarded website Greenbackd, the book Deep Value: Why Activists Investors and Other Contrarians Battle for Control of Losing Corporations (2014, Wiley Finance), and Quantitative Value: a Practitioner's Guide to Automating Intelligent Investment and Eliminating Behavioral Errors (2012, Wiley Finance). He has extensive experience in investment management, business valuation, public company corporate governance, and corporate law.

Prior to founding Eyquem in 2010, Tobias was an analyst at an activist hedge fund, general counsel of a company listed on the Australian Stock Exchange, and a corporate advisory lawyer. As a lawyer specializing in mergers and acquisitions he has advised on transactions across a variety of industries in the United States, the United Kingdom, China, Australia, Singapore, Bermuda, Papua New Guinea, New Zealand, and Guam. He is a graduate of the University of Queensland in Australia with degrees in Law (2001) and Business Management (1999).