Shareholders Unite! Fed up with falling prices, Luby's shareholders took matters into their own hands two years ago. Their coup attempt holds lessons for activist investors.

STOCKS Dissident investors in Luby’s Cafeterias used the Internet to launch a coup to **TAKE OVER THE COMPANY**. By Catherine Siskos

THE LUBY'S cafeteria chain is as Texan as the Alamo, and in the summer of 2000 its financial situation was about as desperate—or so it seemed to the shareholders posting e-mails on a Yahoo! message board. Luby’s was trading for $7.50 per share, down from $19 in October 1997, when Barry Parker took over as CEO, and from a peak of $33 in 1986. Posted messages blamed Parker for lowering Luby’s standards. Noted for its comfort food and homey touches, such as cloth napkins, the venerable dining chain had begun substituting prepared food and paper napkins to cut costs. In less than three years, one-third of the chains managers had quit after the company changed its policy of splitting each restaurant's profit 60-40 with its managers (by one account, the change reduced managers' pay an average of 40% to 50%). One investor compared Luby's to "a 747 at 30,000 feet with two engines out and nothing but fumes left in the wing tanks.

So when shareholders heard in August 2000 that the board planned to renew Parker's contract, they were ripe for rebellion. Leading their ragtag ranks was Les Greenberg, then 57, a semiretired lawyer and amateur investor. Greenberg had been scrutinizing Luby's financial reports, and had spent the first half of 2000 trying to rally shareholders online to act on their grievances. "Change will only come it you make it happen," Greenberg wrote in one message. "Otherwise you're whistling into the cyberspace wind."

At first, investors posting online were more inclined to bicker than to organize, trading insults when they got on each other's nerves and occasionally speculating about who among them might be a management spy. Like truck drivers on CB radios, investors on the message board used handles and abbreviated e-mail addresses, and knew little about each other. A few were former or current Luby's employees who held stock in the company. But most, like Greenberg, were loyal customers who had invested in a business they cared about. Galvanized by the prospect of Parker's reappointment, they began to line up behind Greenberg. "Plgreen, we need a game plan," one shareholder wrote. Greenberg had one: He proposed to lead a shareholder revolt in an effort to win four seats on the company's 11-member board of directors at its annual meeting in January 2001.

A plan takes shape

AT A TIME when the Enron and Global Crossing debacles have left investors feeling betrayed and powerless, the Luby's revolt stands out as a rare example of watch-dog shareholders who fought to protect their investment in a company they believed was headed for bankruptcy. And unlike the shareholders in most uprisings, Luby's rebels were small investors, not powerful individuals or institutions.

Compared with their counterparts 20 years ago, today's shareholders are younger, better educated, wealthier and more likely to manage their investments themselves instead of relying on brokers. They're also more inclined to line up behind proposals that are opposed by company managers and to back dissident slates of candidates, says Aaron Brown, co-founder of eRaider, a mutual fund that invests in troubled companies in order to propose corporate reforms. Linked by the Internet, disgruntled investors have an easier time finding each other and organizing. The Luby's campaign may be the first revolt that was fomented online.

Greenberg discovered Luby's through his wife, Paulette, a native Texan, who remembers the chain fondly from her childhood. Luby's starred in 1948 with a single San Antonio restaurant; today, it runs 201 cafeterias in ten states in the South and Southwest. The company built its reputation on affordable, fresh food made from scratch. Even the mayonnaise is homemade.

The Greenbergs are Civil War buffs who live near Los Angeles and travel frequently throughout the South, eating at Luby's cafeterias. Between 1996 and 2000, they bought 5,600 shares of Luby's for $85,924. Those shares are now worth $36,680.

In March 2000, after the company released a series of gloomy earnings reports, Greenberg feared that Luby's was headed for bankruptcy unless shareholders intervened. On the message board, he unveiled his plan to win four director's seats in 2001, and enough in 2002 to give shareholders a majority.

At a larger company with more institutional investors (who typically don't support dissident shareholders), the idea of seizing board seats from management in a proxy contest would have been pie in the sky. But at Luby's, individual investors held about 60% of the shares. Nevertheless, "the odds favor management unless there are serious concerns about what the company is doing," says Cornish Hitchcock, a lawyer in Washington, D.C., who specializes in shareholder cases.

Time to marshal support

GREENBERG appealed to other dissidents to join him in running for the board, but no one else threw his hat in the ring. In May, he posted his e-mail address and invited shareholders to contact him directly.

In Tyler, Tex., investment manager Thomas Palmer, who owned 4,000 shares of Luby's stock, responded to Greenberg's request and agreed to run. "If there was ever a time when a dissident shareholder could win a proxy contest, it was then," says Palmer.

At about the same time, a group of retired Luby's executives-who together owned hundreds of thousands of Luby's shares-were grumbling over their monthly dinner at a San Antonio Luby's. Worried that Parker was destroying a firm they had spent decades building, they volunteered their expertise to the directors. "We suggested that they put some of us on the board, " says Tommy Griggs, a shareholder and retired senior vice-president. "But they wouldn't nominate us."

Meanwhile, Greenberg's e-mail address found its way to shareholders who had never been on the Yahoo! message board. One of them told Greenberg about Griggs and the other retirees' failed attempt to win nomination for a board seat. Greenberg contacted Griggs with a proposal: If the retirees couldn't run as the company's candidates, perhaps they would be willing to run in opposition, as part of Greenberg's dissident slate.

At first Griggs was skeptical. "I didn't think Les would do much good because he was in California and had no knowledge of the food business," he says. Then rumors surfaced about the renewal of Parker's contract. "That's when we signed up with Greenberg," says Davis Simpson, a retired vice-president who had worked for Griggs.

But the proxy vote was still four months away, and shareholders wanted quick action. Greenberg suggested a letter-writing campaign demanding that Parker be given the boot. The company estimates that it received no more than 20 letters. But in late September, Parker abruptly resigned "to pursue other interests," says Susan Beggs, senior vice-president of investor relations. (Attempts to reach Parker for comment were unsuccessful.)

Although Beggs says Parker's departure was unrelated to the shareholder unrest, investors were emboldened by the unexpected resignation and pressed ahead with their proxy fight for seats on the board. Supporters phoned or wrote letters pledging their votes. "Alot of the callers were saying, 'Thank God for you,'" recalls Palmer.

One shareholder, Elisse Jones Freeman, flew co Los Angeles to size up Greenberg. Her father, Henry Jones, had been a Luby's co-founder and had managed his own Luby's restaurant. Not only did Freeman end up supporting Greenberg but she also agreed to join him, Palmer and Simpson as the fourth candidate for the board seats. Together, the four held three-tenths of a percent of Luby's stock, which was worth about $347,000 at the time, November 2000.

The costs of Insurrection

THE DISSIDENTS didn't have much money to mount a proxy fight. Legal fees to file the necessary papers with the Securities and Exchange Commission can range from $50,000 to $60,000. Then there is the expense of hiring ADP Brokerage Services Group to print and mail proxy cards and tally the votes. At large companies, the price tag can climb into the millions. "You can run for Congress more cheaply than you can run for a board seat," says

Nell Minow, editor of Corporate Library, which tracks shareholder activism (www.thecorporatelibrary.com).

The Luby's shareholders had two cost-cutting advantages. Theirs was a small company, with only several thousand shareholders, and Greenberg was a lawyer. While he handled the legal paperwork, Palmer and a few other investors put up the cash, with Griggs contributing the lion's share, $10,000. In the end, the dissidents spent just $15,000 on their campaign, compared with the $250,000 the company spent to fight them.

Palmer phoned 75 of Luby's biggest investors to court their votes. Greenberg spent an hour with Institutional Shareholder Services (ISS), which recommends to institutional investors how they should vote at annual meetings, and ISS promised to consider their concerns. But Greenberg and Palmer got a chilly reception at the Vanguard Group, which in November 2000 held about 400,000 shares of Luby's, mostly in index funds. Although the men had large personal accounts with Vanguard, says Greenberg, "we couldn't even present our case."

Still, the dissidents seemed to be having an effect. Under chairman David Daviss, who took over as acting CEO after Parker resigned, Luby's began to reverse some of the unpopular practices that had angered shareholders. Restaurants returned to making food from scratch, and the company reformulated its compensation to give managers a bigger slice of the profits.

Daviss also nominated Jim Woliver, a retired Luby's executive, to be one of the company's board candidates. Woliver, a 33-year Luby's veteran and former senior vice-president, had retired to his ranch near Waco but jumped at the chance to serve on the board. "As a stockholder, I was not pleased that the stock had slipped," he says.

Daviss maintains that the impending proxy contest did not influence his decisions. "Nothing we did was intended to appease shareholders," he says. "We were trying to manage the company in a difficult time, and the proxy contest slowed down that process by two or three months."

But Patrick McGurn, vice-president of ISS, believes that shareholders influenced company reforms. What typically happens in these cases, says McGurn, is that "the company has to co-opt the dissidents' agenda to win."

In any event, Daviss's moves shattered Greenberg's coalition. In November 2000, two months before the annual meeting, Griggs, Simpson and William Snyder, another former Luby's executive, withdrew their support. The retirees approved of the reforms, and Simpson felt guilty about opposing a company that still employed many friends and former colleagues. "I had personally recruited most of the managers off college campuses," he says. The retirees even tried to get their money back from Greenberg, but backed down after an exchange of letters through their attorneys.

The voting went ahead, with the dissidents taking an early lead. But as the ballots trickled in to ADP, it became clear they would lose the election. On the night before the annual meeting, Greenberg and Palmer commiserated at their first face-to-face meeting-over dinner at Luby's.

A taste of victory

THE ANNUAL meeting was held in the packed ballroom of a San Antonio hotel, with shareholders standing three-deep against the wall. The election results were now official: The dissidents had received 25% of the vote-an astonishingly high percentage for small investors. Still, they had lost, mostly because they had failed to gain the coveted support of ISS. Parker's departure and the company's other changes had convinced ISS that Luby's was "back on track," says McGurn. After the company's victory was announced, one investor after another got up to lambaste the board. After two hours, board members turned off the microphone and fled, without bothering to adjourn the meeting.

During the past year, Daviss has stepped down as chairman and CEO. Christopher and Harris Pappas, two brothers with their own successful restaurant business, have come to Luby's aid, injecting $10 million of badly needed cash into the company. Together, Christopher, who is now president and CEO, and Harris, who is chief operating officer, own 6% of Luby's. The stock (symbol LUB) rebounded briefly, hitting $10-its high for 2001-in June. It now sells for $7.

Luby's won't be a quick fix. It closed 11 cafeterias in the past year, lost $32 million in the fiscal year that ended August 31, and dropped $5 million more in the subsequent quarter. "Because so many of the old managers left, it's going to take a few years for the company to recover," says Bill Baldwin, a partner with Baldwin, Anthony & McIntyre, a Dallas brokerage.

On the Yahoo! message board, investors continue to chew over every bit of Luby's financial data. Although the dissidents lost the election, Greenberg tallies their victories: "We put the spotlight on the board of directors, which mismanaged the company. We got rid of Barry Parker, and without that the board would have told the Pappas brothers to get lost." Greenberg still keeps a watchful eye on the company's bottom line. "To get the shareholders together again," he says, “would be very easy." **K** -*Reporter*: ERIN BURT

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