

Boston Bean Co. (BBCO)**Case Study for
Stybel Peapody/Board Options, Inc. Seat At The Table
The Shareholder Activist Comes Calling
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November 17, 2016****Background**

Boston Bean Co. (BBCO) processes beans and other produce primarily as canned foods. It has operations in Massachusetts and North Carolina. The company provides canned vegetables and fruit, which are distributed to consumers through chain supermarkets.

BBCO is a publicly traded company and is currently independent. It was historically a family-owned operation and is currently led by Fred Funk, the grandson of the original owner. With an 80-year history, Boston Bean's growth is generally at or below the rate of inflation. In recent years, its revenue and earnings growth have been essentially flat, and the company has relied almost exclusively on acquisitions for new sources of revenue. As a result, its share price has steadily declined and its Total Shareholder Return over the past three years has been significantly below the peer group average. The company also has struggled to integrate an overpriced acquisition that investors perceive as a sign of either "empire building" or desperation by the CEO. To further compound matters, the nine members of the board of directors, initially culled from the CEO's personal friends and contacts, have been together for several years, leading to accusations of stagnancy and complacency.

Concerned Shareholders of Boston Bean Co. is made up of two hedge funds that together own 5% of BBCO's common stock and hold an additional exposure to 4% of the company's market value through certain derivative products. Concerned Shareholders is dissatisfied with BBCO's performance and strategy. The activists entered the stock three quarters ago and have been secretly meeting with Funk, lobbying for significant changes to the operating structure, capital allocation and a potential breakup. The activists have shared many of these ideas with Funk on several occasions over the past two quarters, but he never took them seriously and neglected to convey the proposals to the board of directors.

An overview of the financial condition is shown at the end of the case study.

It is late on a Friday in January. The board and senior management team members have been told on short notice to cancel any previous engagements and gather in the boardroom at 5 p.m. The company's Chairman and CEO, Fred Funk, has called the meeting. In addition to the Board of Directors, members of management in the room are Owen Top, BBCO's President and COO, Johnny Walker, Chief Financial Officer, Henry Hyde, Vice President Legal, and Larry Little, Vice President of Investor Relations.

Funk announces to the group that he received an extensive white paper from two hedge funds in New York that believe they know how to run the business better than Funk and they want to nominate three members to the nine-person board. They plan to release the white paper over a wire service in the form of a news release early next week. Funk admits to the board that he has known about the funds' proposals for months. He doesn't have time to go into all the details, and he needs to decide how to proceed. He says, "This is a strong company with a great future in front of it." He believes the company simply needs time to work through its current slowdown in earnings and the stock will bounce back.

However, as officers and directors of a public company, the group has a fiduciary duty to do what is in the best interests of shareholders. Funk looks around the room and expects some solid recommendations. **What questions do you have for Funk? The President? The CFO? The IRO?**

History:

In 1936, Funk's grandfather, Felonious, founded Boston Bean in his garage. He borrowed enough money to build a small processing plant, and he made his first sale to a local grocery store chain. Backed by his first significant order, Felonious Funk expanded his processing capabilities and produce types, and the business thrived.

Sixty years later, Boston Bean was no longer thriving on its own. Fred Funk had inherited the business, and needing an infusion of cash, he took the company public with backing from Bear Sterns and Merrill Lynch. The stock was traded on the Nasdaq under the symbol "BBCO."

Throughout the late 1990s, the business capitalized on a vegetarian craze and had a mild resurgence. But as the economic boom waned and customers traded in beans for chicken, BBCO's business plummeted.

But Funk could always smell a good deal. In 1999, he had acquired a small, privately held company called CarrotCo, based in North Carolina. CarrotCo sold frozen carrots and other cold produce, and Funk saw the perfect opportunity to diversify his product offerings and cross-sell Boston Bean's catalog into the South. He renamed the new division BosCarrot and managed to grow the combined business by 7% during the next five years.

In 2002, Funk made another acquisition. The Atkins craze had erupted, and he knew that BadFoods was a small donut company about to go bankrupt. Based on his previous M&A success, Funk was convinced he could make the business profitable. He bought BadFoods at a steep discount, but by 2005, the BosFoods division was still struggling to turn a profit.

Also in 2005, at the age of 57, Funk began to search for a successor. At the behest of the board, the company conducted a search and eventually hired 36-year-old Owen Top as Chief Operating Officer and the designated heir apparent. Coming from a Big Four consulting firm, Top's background had little to do with any of BBCO's three product lines. But Funk persuaded the board that Top's expertise in management consulting and his entrepreneurial spirit made him the perfect candidate to eventually become CEO, despite Top's lack of direct experience.

By 2012, BBCO was floundering. The share price had not moved for two years, and the business, while still profitable overall, was facing increasing competition from food processors in other regions. The BosCarrot and BosFoods units were being propped up by the original business.

Funk was obviously concerned. He had staked the future on Top and wanted to see whether his COO could handle this difficult situation. Funk promoted Top to President and directed him to develop a new growth strategy.

With his new responsibilities, Top put on his consultant's hat and determined one more acquisition would give Boston Bean the scale it needed to accelerate growth and drive increased profitability. From the beginning, he was met with resistance from the board. The directors did not believe the company was on strong enough financial footing to digest a new acquisition. But Funk continued to back Top. Together, they convinced the board to proceed and in May 2013, BBCO made an initial cash offer of \$65 million for OregonBerries, a fruit canning and winemaking operation in the Pacific Northwest. Top began to canvas shareholders to persuade them that this was a good deal for Boston Bean.

The company's major investors were not enthusiastic; they had watched BBCO shares languish with little appreciation for five years. Meanwhile, another bidder emerged for OregonBerries. This new firm, LA Lettuce, offered a 25% premium to Boston Bean's offer. Top, afraid of losing the deal, convinced the board to increase its offer to 30% (\$70 million), which was at the fringe of making the deal accretive. In November 2013, following a difficult shareholder vote, the acquisition went through and it was renamed BosBerries.

However, the food business can sometimes be rotten. Top soon found he had overpaid for the fancy-looking cannery. He fired many of the original employees and replaced them with his own people, none of whom had any experience with the Pacific Northwest wine industry. As a result, the BosBerries unit was never fully integrated into Boston Bean.

Current Situation:

The company consists of four main business lines:

- **BosBean:** The original business. Provides canned produce to supermarkets in New England and New York. The line is profitable and steady.
- **BosCarrot:** Provides frozen foods to supermarket chains in the South and Mid-Atlantic. Population growth in the regions has led to consistent single digit growth during the past several years, but with a large unionized work force, the cost structure has sapped profits.
- **BosFoods:** One of a dwindling number of donut companies in the U.S. Its heyday is clearly behind it.
- **BosBerries:** Acquired in 2013. Provides canned fruit and specialty fruit wines to independent, high-end restaurants on the West Coast. The business has been losing share and money since its acquisition and has never been integrated.

BBCO Directors

Class I Director (2017)		Class II Director (2018)		Class III Director (2019)	
Name	Years of Service / Profession	Name	Years of Service / Profession	Name	Years of Service / Profession
Sam De Lux	15 / Funk's college roommate	Stan Pat	9 / Real Estate agent	Fred Funk, Chair & CEO	20
Syrious Cash	12 / High-tech CEO	Les Honest	9 / Retired school teacher	Max Greene	18 / Investment advisor
Long Stocke	14 / Day trader, friend of the family	Holden On	20 / Longtime supplier	Dewey Cheetham	13 / Outside corporate counsel

Concerned Shareholders Director Nominees

Class I Director (2017)	
Name	Background
Gnu Blood	Industrial CEO
Alotta Trubl	Former CFO
Cash N. Inn	Activist Investor

BBCO Shareholders

Firm Name	% O/S	Position	Investment Style	Turnover	Orientation	City
Royce & Associates, LLC	9.70	7,761,950	Value	Low	Active	New York
DePrince, Race & Zollo, Inc.	8.12	6,497,632	Yield	Mod	Active	Winter Park
Dimensional Fund Advisors, LP	7.79	6,233,566	Core Growth	Low	Active	Santa Monica
Fidelity Management & Research Company	6.52	5,217,311	GARP	Low	Active	Boston
Concerned Shareholders of Boston Bean Co	5.03	4,025,011	Value	High	Active	New York
BlackRock Institutional Trust Company, N.A.	4.10	3,280,824	Index	Low	Passive	San Francisco
Vanguard Group, Inc.	4.05	3,240,814	Index	Low	Active	Malvern
Renaissance Technologies Corp.	3.87	3,096,778	Hedge Fund	Mod	Active	New York
Northern Trust Investments, N.A.	3.11	2,488,625	Index	Low	Active	Chicago
TIAA-CREF	3.02	2,416,607	GARP	Low	Active	New York
Invesco Advisers, Inc.	2.97	2,376,597	GARP	Low	Active	Atlanta
Tieton Capital Management, LLC	2.91	2,328,585	Aggressive Gr.	Low	Active	Yakima
Barrett Asset Management, LLC	2.78	2,224,559	Core Growth	Low	Active	New York
Geode Capital Management, L.L.C.	2.63	2,104,529	Index	Low	Passive	Boston
BNY Mellon Asset Management	2.54	2,032,511	Income Value	Low	Active	New York
Northern Trust Global Investments Limited	2.23	1,784,448	Core Growth	Low	Active	London
California Public Employees' Retirement	2.09	1,672,420	Index	Low	Passive	Sacramento
American Century Investment Management,	2.01	1,608,404	Core Growth	Low	Active	Kansas City
BlackRock Investment Management, LLC	2.00	1,600,402	Value	Low	Active	Princeton
Bank of America Merrill Lynch (US)	1.87	1,496,376	Broker-Dealer	Low	Passive	New York
California State Teachers' Retirement System	1.84	1,472,370	Index	Low	Passive	West
Brown Advisory	1.72	1,376,346	GARP	Low	Active	Baltimore
Crawford Investment Counsel, Inc.	1.67	1,336,336	Income Value	Low	Active	Atlanta
WEDGE Capital Management, L.L.P.	1.58	1,264,318	Core Value	Low	Active	Charlotte
GSA Capital Partners LLP	1.53	1,224,308	Hedge Fund	High	Active	London
Lord, Abbett & Co. LLC	1.51	1,208,304	Core Growth	Mod	Active	Jersey City
Phillips, Hager & North Investment Management	1.50	1,200,302	GARP	Mod	Active	Vancouver
RBC Global Asset Management Inc.	1.48	1,184,298	Core Value	Low	Active	Toronto
Bridgeway Capital Management, Inc.	1.15	920,231	Aggressive Gr.	Mod	Active	Houston
Mellon Capital Management Corporation	1.07	856,215	Index	Low	Passive	San Francisco
Eagle Global Advisors, LLC	1.11	888,223	Core Growth	Low	Active	Houston
Deutsche Asset Management Americas	1.02	816,205	Core Growth	Mod	Active	New York
LSV Asset Management	0.98	784,197	Deep Value	Low	Active	Chicago
Stifel Nicolaus Investment Advisors	0.81	648,163	GARP	High	Active	St. Louis
PanAgora Asset Management Inc.	0.74	592,149	GARP	Low	Active	Boston
Acadian Asset Management LLC	0.42	336,084	Deep Value	Mod	Active	Boston
TIAA Global Asset Management	0.28	224,056	GARP	Low	Active	New York
Mill Road Capital Management LLC	0.25	200,050	Hedge Fund	Low	Active	Greenwich
	TOTAL:	80,020,102				

Boston Bean Co. Financials, 2012-2016
(\$ in thousands)

		Actual 2012	Actual 2013	Actual 2014	Actual 2015	Projected 2016
Sales		800,000	880,000	1,012,000	1,042,360	1,042,760
% Growth		5%	10%	15%	3%	0%
COGS		560,000	616,000	708,400	729,652	729,342
BosBean		150,000	163,000	170,000	173,000	172,900
BosCarrot		225,000	235,000	241,000	243,000	242,900
BosFOods		185,000	215,000	219,000	222,000	221,900
BosBerries		-	3,000	78,400	91,652	91,642
Gross Profit		240,000	264,000	303,600	312,708	313,418
%		30%	30%	30%	30%	30%
SG&A		120,000	132,000	161,920	166,776	166,750
%		15%	15%	16%	16%	16%
Operating Expense		120,000	132,000	161,920	166,766	166,750
Operating Income		120,000	132,000	141,680	145,932	145,948
Operating Margin		15%	15%	14%	14%	14%
Interest Expense		0	3,200	8,200	8,200	8,200
Tax Rate		35%	35%	35%	35%	35%
Net Income		78,000	83,720	86,762	89,526	89,542
Avg. Shares Outstanding		80,020	80,020	80,020	80,020	80,020
EPS		\$0.98	\$1.05	\$1.08	\$1.12	\$1.12

Challenge Questions:

1. What questions do you have for the CEO? The President? The CFO? The IRO?
2. What are the first steps the board should take? Why?
3. What are some of the most important considerations?
4. Do you believe the company should respond? If so, in what form, by whom and what is the message?
5. What are the potential consequences of your response?
6. What are the expected outcomes?
7. How should you prepare as a board member for the response?
8. What questions should be asked of the activist group: Concerned Shareholders?
9. In hindsight, what could management and the board have done differently?