Biglari Holdings (BH)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Biglari Holdings - business

- Restaurants (98% revenue...):
  - Steak n Shake - premium burgers and milk shakes (413/76)
  - Western Sizzlin - steak dishes + American menu (5/89)
- Investment advisory services to private investment funds
  - Lion Fund
- BH investments (115M)

Biglari Holdings – business (cont'd)

- Investment on jockey, not on the horse…
  - CBRL, CAW activist investments

Biglari Holdings – Misc thoughts

- What can go wrong?
  - Restaurants fail to do well
    - Mostly crappy business anyway
  - Biglari fails in his investments
    - Activist failure
    - Non-activist poor investment selection
    - Hedge fund incentive structure

Biglari Holdings – Misc thoughts

- Opportunities:
  - Biglari's success with investments
    - Successful takeover of Western Sizzling and Steak & Shake
    - Successful sale of Friendly's position
  - Restaurant RE appreciation?

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? None (Biglari as person?)
  - What does it take to sustain the moats? None.
  - Bargaining power of suppliers/customers? N/A
- Is it a low risk business? Medium to high.
- Is there high uncertainty? Medium to high
- How capital intensive is the business? Not very
- Future growth – saturation? N/A
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? No.

Management

- No dilution
- Can I trust management?
  - I hope so
- Management shareholding (> 10%)
  - Yes
- Management incentives?
  - So so
- Are the salaries too high?
  - So so
- Is there heavy insider buying?
  - Somewhat
- Is there heavy insider selling?
  - No

Management (cont’d)

- Do I like the management? (Operators, capital allocators, integrity)
    - Maybe
- Profitable reinvestment
    - Yes, so far
- What has management done with the cash?
    - Invested
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
    - Stock investments

Piotroski Score

Only applicable to Graham Cos – N/A to BH

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9

Is it a good business?

- Too short history
- ROE:
  - 2010:11 2011:12 2012:9
- Margins
  - 2010:4 2011: 5 2012:3
- 3 year sales growth 7%, earnings growth 64% (not repeatable)
- No dilution
- Strong balance sheet
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - ~ ROE

Is it a good business? Cash flow

- Good operating cash flow, FCF:
  - 2011 34M earnings, 71M operating cash flow, 58M FCF (FCF = OCF – capital expenditures)
  - Free Cash Flow/Share higher than dividends paid

Is business cheap? - Buffettology calculations

- ROE 12%
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $103M
- Equity in 10 years = Equity*$(1+ROE)^9$ = $860M
- Market cap = 103M x P/E (15) = $1.5B
- Rate of return = 9% after tax (calculations omitted)

- 9 year earnings growth: N/A.

Is business cheap? DCF

- Discounted cash flow
    - Current earnings of 34M (FCF 58M)
    - 10% growth for 5 years, leveling after that
        - 15% discount -> $330M current valuation
    - 5% growth for 10 years, leveling after that
        - 15% discount -> $300M current valuation
    - 15% growth for 10 years, leveling after that
        - 15% discount -> $566M current valuation
- Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
    - 34M / (560M) = 6%

- What makes up the margin of safety? Biglari?
- Is there a sufficient margin of safety? Probably not.

Is business cheap? – Graham investment considerations

- N/A for BH – included for completeness
- 1.8 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)