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)