



Danger Zone: Is Biglari (BH) the Next Berkshire? Think Again

Check out this week's Danger Zone interview with Chuck Jaffe of [Money Life](#) and MarketWatch.com.

For a number of years, the financial media has been anxious to anoint the next Warren Buffett. One contender that has received considerable media attention is Sardar Biglari, chairman and CEO of Biglari Holdings (BH). Biglari is the majority owner of Steak 'n Shake, Western Sizzlin', First Guard Insurance, and most recently, *Maxim* magazine. We will show that not only does Biglari Holdings (BH) make a poor substitute for Berkshire Hathaway, but also that investors in Biglari Holdings are taking on more risk than they've been led to believe.

Where the Similarities Start...

There are more than a few similarities between Sardar Biglari and Buffet. The initials of their companies (Biglari Holdings vs. Berkshire Hathaway), the high share prices of each, and the very similar websites of their holding companies.

These are likely not coincidence, as Biglari has openly stated that he was initially inspired to invest by reading a Buffett biography. Less than a year after taking control of Steak 'n Shake and turning it into a holding company, Biglari enacted a 20-for-1 reverse stock split that sent the price of shares from \$13 to about \$260. He later attempted a subsequent 15-for-1 split that could have taken the price to nearly \$7,000. Other similarities between the two investors are more uncanny, like the fact that Biglari and Buffett have the same birthday.

... And End

While these shared characteristics have inspired a number of comparisons, they do not make an investment thesis. Figure 2 shows how Biglari stacks up to Berkshire Hathaway in terms of our most important metrics: net operating profit after tax ([NOPAT](#)), return on invested capital ([ROIC](#)) and price to economic book value ([PEBV](#)).

Figure 1: No True Competitor

Company	Ticker	5-Year NOPAT		
		CAGR	ROIC	PEBV
Biglari Holdings	BH	7%	4%	33.8
Berkshire Hathaway	BRK.A	26%	9%	1.5

Sources: New Constructs, LLC and company filings.

Biglari ranks behind Berkshire in every metric.

Sardar Biglari's style is much different than that of Buffett. While most Americans might not know that Buffett is the sole owner of companies like Dairy Queen and Fruit of the Loom, Mr. Biglari has taken an active role in Steak 'n Shake, going so far as to add his signature to the Steak n' Shake signs in some locations, and to hang a picture of himself near the entrance of Steak 'n Shake locations.

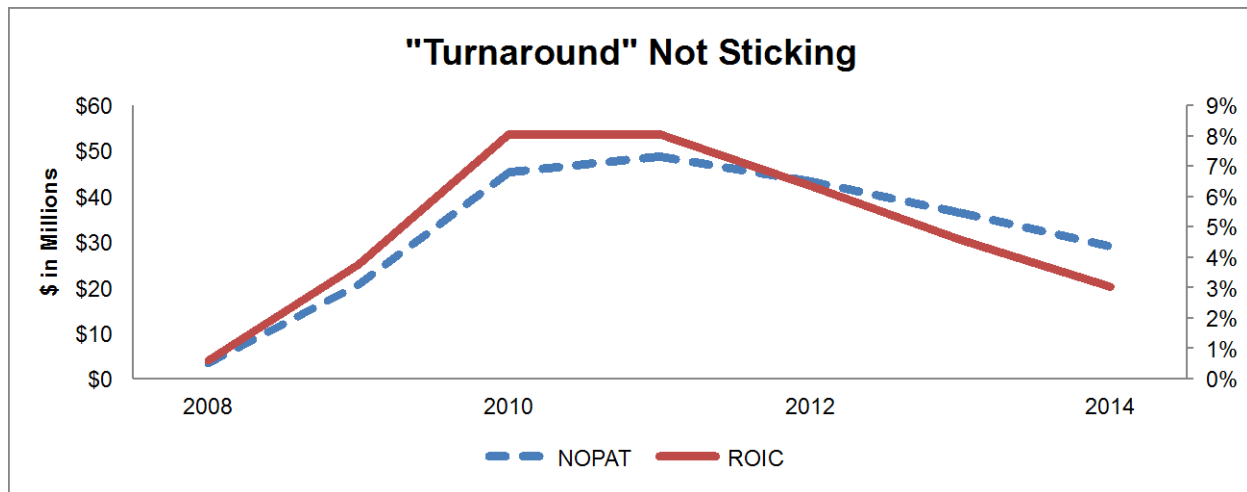
This is A One-Trick Pony

The issues with Biglari Holdings are more than skin deep. Let's take a closer look at what makes BH a bad investment.

Biglari certainly had some success in his initial turnaround at Steak 'n Shake, starting in 2008. Between 2007 and 2010, Biglari Holdings' NOPAT rose from \$29 million to over \$45 million, and its ROIC rose from 5% to 8%. More recently, Steak 'n Shake's same-store sales increased 3% during 2014, customer traffic increased by 2%. Meanwhile, the number of stores increased 4% from 519 to 540 in 2014.

However, figure 1 shows that this uptick in profitability did not last long.

Figure 2: Is Biglari a One-Trick Pony?



Sources: New Constructs, LLC and company filings.

This decline in NOPAT between 2012 and 2014 was due to an almost \$20 million increase in SGA. While revenues increased by less than 3% compounded annually between 2012 and 2014, cost of sales increased by almost 4% annualized and SGA increased over 8% annualized.

Besides Steak 'n Shake, it's unclear what else would make Biglari Holdings an attractive investment. Western Sizzlin', Biglari's other restaurant holding, has seen 17 of the 92 stores close in the last two years. Biglari conveniently neglects to provide same store sales data for Western Sizzlin' as it does for Steak 'n Shake.

Last year, Biglari bought First Guard Insurance, a commercial trucking insurance underwriter. However, it's too early to tell how successful Biglari's insurance business will be at this point. The contribution of the insurance business to net earnings was \$964,000 in 2014.

Biglari also purchased *Maxim* last year, a troubled men's lifestyle magazine, reportedly for somewhere between \$10-15 million. This may not seem like a substantial amount, but Biglari's 2014 NOPAT was just \$29 million. *Maxim* lost Biglari -\$10 million in earnings in 2014. As Biglari pours money into this business over the course of the next year or so (including several [high profile hires](#)) expect *Maxim*'s downward pull on Biglari's profits to increase. As a print magazine, we have little faith in *Maxim*'s ability to become a cash flow machine for Sardar Biglari, who has no experience in publishing.

Biglari is No Berkshire Clone

As a result of Steak 'n Shake's slowing growth and the questionable value of Biglari's other purchases, Biglari's ROIC dropped to under 5% in 2013 and to 3% in 2014.

Berkshire Hathaway's largest equity investments are in cash flow-rich companies like Wells Fargo (WFC), American Express (AXP), and Walmart (WMT). Biglari's cumulative free cash flow since 2008? A loss of -\$288 million.

An Unusual and Alarming Red Flag Rears its Head

Biglari has \$86 million in [deferred tax liabilities](#) (10% of market cap), as well as \$417 million in total debt (49% of market cap) which includes \$93 million in [off-balance sheet debt](#). These items represent claims on future cash flows.

The most concerning issue of all, however, is Sardar Biglari's compensation. Last year, Mr. Biglari received nearly \$11 million in compensation, and around \$10 million in 2012. While Mr. Biglari has had some success with Steak 'n Shake, it seems inappropriate to reward himself with a salary that eclipses that of Don Thompson, CEO of McDonalds (MCD).

Adding to the trouble is a statement in Mr. Biglari's contract that provides him "performance-based annual incentive payments contingent on the growth of the Company's adjusted book value in each fiscal year." This

clause could very well be the reason behind the acquisition of a failing company like *Maxim*. So long as his company's book value keeps rising, Mr. Biglari keeps getting paid – an amount which reached 30% of his company's NOPAT in 2014.

It also seems unlikely that Sardar Biglari will be unseated any time soon. A part of his contract with the holding company states that if Mr. Biglari is ousted as CEO, he will receive 2.5% of Steak 'n Shake sales for the usage of his name for a minimum of 5 years. Looks like a change in control could cost this company dearly for at least five years, which gives Mr. Biglari significant leverage in keeping his position.

Too Many Catalysts to Count

Biglari Holdings owns almost 20% of Cracker Barrel's (CBRL) stock. If Cracker Barrel's stock falls, it will certainly impact the value of BH shares. In addition, if Sardar Biglari is unable to turn around *Maxim* and the magazine keeps its status as a -\$10 million cash flow black hole, it's likely to be sold for even less than what Biglari paid. Finally, if the decline of Western Sizzlin' accelerates, Sardar Biglari may need to write off the chain or sell it. On the flip side, if he attempts to revive the dying chain, shareholders could disapprove of this move as a waste of time and money.

A High Price With All the Wrong Indicators Makes For the Worst Kind of Investment

To justify its current price of \$414/share, Biglari would need to grow NOPAT [by 18% compounded annually for the next 12 years](#). At this point in time, a bet on Biglari Holdings is a "bet on the jockey," as Sardar Biglari likes to say. We'd rather bet on the horse than the jockey, and this horse doesn't have the fundamentals to make us confident that it can meet expectations.

Let us think "long term" like Mr. Biglari. If the holding company can grow NOPAT by 8% compounded annually for the next 20 years (essentially the level of profit growth during the Steak n Shake turnaround), [the stock is worth \\$215/share](#), a 48% downside.

Over the past five years, Sardar Biglari has delivered a 33% return for his shareholders, compared to over 77% for the S&P 500. We think there are better places for investors to park their hard-earned money without the risk that it will go to turning around a cash-strapped company in a struggling industry for a mediocre return — or worse, straight to the pockets of the company's CEO. There is a large amount of value in the company's stake in the holdings of Sardar Biglari's hedge fund, The Lion Fund, but these investments are far from guaranteed cash flow, despite the fact that most of Biglari Holdings' 2014 income is investment and partnership income. Investors should be aware that their value of an investment in BH requires taking on risks more akin to a hedge fund than a stable restaurant business.

Short Interest

Short interest stands at around 52,000 shares, or 3% of float.

Insider Transactions

In the past six months, insiders have purchased a net 172 shares. This represents a total increase of 0.4% to insider holdings, and much of this buying may be due to Biglari fulfilling the terms of his incentive compensation agreement that require him to use 30% of his bonus to purchase shares of BH.

Disclosure: David Trainer and André Rouillard receive no compensation to write about any specific stock, sector, or theme.

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