

## Biglari Holdings- FY 2014 Annual Meeting 4/09/2015

Note: Nothing should be taken as a direct quote. Some of the numbers may be wrong as it was difficult to hear a few times. I also missed a few questions and left at 5:45pm.

- Introduced directors
- Swenson introduced and makes a statement
  - It's clear corporate governance must be reformed
  - We don't expect to win any seats this year
- Preliminary report on voting results
  - Biglari slate has received plurality of votes cast
  - Final tabulation will be revealed in an 8K in 2-5 days
- Pre- Q&A remarks
  - Biglari began to invest in Steak 'n Shake (SnS) in early '07
  - Realized there were serious problems by late '07
    - Last 3 months of '07, same store sales (SSS) were down 13%
    - BoD puts SnS up for sale and received offers at a discount to market price
  - August of '08 SnS debt covenants were violated and the co. was quickly losing cash
    - SnS becoming a footnote in the history of brand names
    - Sardar tried to convince interim CEO to stay longer but he saw the writing on the wall
    - Potential CEO turned down a generous offer
    - Impossible to get sale-leasebacks done in the midst of financial crisis
  - Biglari had to make drastic changes at the company
    - Eliminated products/simplified the menu
    - Reduced core menu item prices by 24%
    - Simultaneously improved quality
      - You cannot simply take one decision, apply it to another chain, and have it work.
      - It isn't profound enough to change one element- you must go into it area by area and make changes
    - Red Robin was better able to withstand problems because of superior cash inflows
  - Biglari and Cooley do not want to reinvest the cash from operations into restaurants.
    - The holding co. is organized to be in any business, run for the investors
  - First co. Biglari started took \$15K
    - 'Not like we raised billions and got to this position.'
    - Came up from nothing by following a set of principles
  - BH Principles (listed in a slide deck):
    - Maximize intrinsic value
      - Not EPS/operating income
      - The most important of all of the principles here

- Turning around businesses will create outsized returns but with lumpy results
    - Own businesses
    - Capital allocation advantage
      - We can look at companies in other industries
      - We can put capital anywhere that offers the largest return per unit of risk
      - If First Guard (FG) is able to reinvest their cash, that's quite alright with us.
    - Centralization of capital
      - Allocation decisions made by Biglari, not a committee
      - Don't have layers upon layers of management
      - In investing, you need central decision making for outsized returns
        - There are exceptions to this rule but this is most often true
    - Outperforming and underperforming businesses are interesting
      - First Guard is an outperforming business
      - Maxim is an underperforming business
    - Capital structure advantage
      - No debt at the parent level
    - Long term orientation
      - Longer duration opens the field to create value
    - S&P 500 is the benchmark
      - 'If we don't beat it over the long term, there is no reason for this organization.'
      - Not looking to beat it over a one year, three year, or even five year horizon, but over the long term.
  - Balance sheet of the company is much stronger today than when we started
    - Only someone with an ulterior motive would say otherwise
  - In 2010, I told you guys to stop bidding up the stock
    - You thought I was joking but the stock got way ahead of the business in '09 and '10
    - For this reason, in April of '10, we tried to use the stock to buy Advance Auto.
      - In April 2010, stock would have been maybe \$330/share adjusted for rights
      - We tried to take advantage of the price back then but we remain unconcerned about price in the short term
  - In closing, we do things differently because we're guided by logic and in it for the long term holder, not the short term trader
- Q: Did the movement of funds from the hold co. to the Lion Fund (TLF) require a vote?
  - Independent directors voted on it
- Q: Would you provide an update on efforts to franchise in Saudi Arabia?

- It's been painfully slow but should see the first unit in May
- Q: Please provide us with a review of First Guard.
  - It is a trucking insurance businesses
  - Gross premiums were \$18.4mm last year, up from \$15.7mm in the prior year
  - Historically the company has ceded a lot to reinsurers
    - Used to retain 60% of property liability but that's now up to a 75-25 split
    - Non-trucking (when truck is used for personal reasons) is a very uncertain line and so 90% used to be ceded. Now it's 50%
  - Pre-tax profit of 2.6mm vs. 2.05mm last year
    - \$1.8mm of after tax profit vs. \$1.4mm last year.
      - Should grow at about the same pace in the coming year
  - First Guard is going to start selling more coverage in areas that they have built up the required expertise
  - People think that insurance is easy- you just get float and invest it (FG doesn't have any float)
    - Then you meet the regulators
  - Combined ratio is going to come in above 80 some years and below 80 in others.
- Q: Can you talk about the economics behind the CBRL forward transaction?
  - We have not sold any CBRL
  - It is a financing arrangement plus a hedging arrangement
  - It is a method to maintain ownership with a \$131-\$157 collar
  - The cost is \$29mm, we still get dividends
    - Net cost is \$16.5mm to unlock \$130mm
    - Just under a 7% cost and we don't have to trigger capital gains
  - We don't want to borrow on the stock unhedged.
  - Should price go below \$131, it will cost us less. Goes above \$157, will cost more
  - JPM is the counterparty
- Q: Is there any requirement for TLF fees to be reinvested in BH stock?
  - No, but I increase my personal holdings of BH through TLF
    - Recently put \$8.5mm into TLF
- Q: With interest rates so low, how do you look at further insurance investments?
  - If we find another first guard we will buy them
  - It doesn't matter what interests rates are with combined ratios as low as FG's
  - Fremont was worse.
    - We had price discipline but maybe not quality discipline
  - People have all sorts of strange ways of valuing companies now
    - Want you to pay for the earnings and then pay for the assets as well
  - We are not forced to act
- Q: What about investments into TLF that were used to repurchase BH stock?
  - The board was wise to contribute money to TLF because \$.5B has been gained on investments

- Rights offerings have helped with refinancing
- If you look at SnS from its founding through 2008, the company spent about \$900mm on capex and earned \$470mm in operating income
  - Since current management took over, gains on investment have exceeded 70-some years of operating income
- All of our investment income is liquid too
- Q: What was the plan/logic behind the investments in AirT and Insignia?
  - Look at the 13Ds we filed
  - When I got the letter regarding the dissident slate, I had to do the research so why not make some money too
    - I saw some things they could do to increase value
- Q: This is a cultural question regarding the private planes. Why not fly coach?
  - If I have to ride a camel or get on a jet to create the most value, that's what I will do
  - The planes are highly efficient
    - I can lose 20% of a work week using a commercial airline
    - It's about being as productive as possible
  - 'When we first got fractional interests, we asked the executives who wanted to fly. Everyone volunteered. I had them working so hard during the trip that the next time I asked, there were five empty seats.'
  - We felt that everything should be disclosed
  - We used the interests to fly down for the FG acquisition
  - Cooley: "We do not have a fleet of planes."
- Q: Could you disclose travel expenses?
  - We give the information necessary to arrive at an intrinsic value
- Q: Are there going to be any changes to avoid this in the future/what did you learn from this?
  - There are more idiots in the stock market than we previously thought
  - The lack of knowledge was amazing. There were some people from the dissident slate who hadn't even read the chairman letters.
    - There are people who are perceived to be savvy that don't know stuff either
  - There is a high education cost to own BH. We need educated shareholders
  - Cooley: I love talking to people that do deep dives and can have an intelligent conversation
- Q: What is the expected future run rate for operating margins?
  - We inherited a non-existent franchising operation
  - Gus Belt would give franchises to his friends; the first was in 1939
    - The prior management would give them to failing employees
  - We learned from Western how not to do it.
    - Western had 500 units at one point
  - We have had to spend money on training, hiring salespeople, etc
  - Revenue has gone from \$4mm to \$12mm
  - We spent \$16.9mm on franchising last year, including some legal/court costs

- The bulk of it is spent on recruiting employees, designing concepts, setting up the supply chains, etc
    - We anticipate that in about 18 months, the revenue will exceed franchising expenses
    - We have \$31mm so far invested in franchising
      - 50% margin on the 8mm in incremental revenue gets us to a double digit return
      - You don't invest on day one and expect a return on day two
    - We have made mistakes on both sides
      - Decommitments
- Q: By my calculations, we've invested about \$20mm into Maxim and you said a turnaround would take 2-3 years. Where do we stand?
  - We will know for certain in 2016 how we're doing
  - The way to think about Maxim is to simplify
    - We show \$21.5mm in pre-tax losses
      - There is a tax synergy because we can offset the losses with gains from SnS
      - Say total cost is \$50mm, after tax that's 31mm.
    - We could sell it for \$20mm, call it after tax
  - There are a number of things that could give us tremendous upside
  - Upside of \$100mm, downside of -\$11mm [-\$31mm after tax + \$20mm sale]
  - The risk is shifting- Maxim is more certain today than when the chairman letter came out.
  - Maxim is the largest general interest men's magazine. 2X the next largest
    - We have a broad segment and competitors have a narrow segment
    - We can sell ads for segments that have not declined: luxury, grooming, fashion, etc.
    - Advertisers can use one magazine instead of several
  - We raised ad rates 30% yet ad pages went to 24 from 17.
  - Commitments for ads in the coming year exceed last year's revenue
  - We got into Maxim for licensing, not publishing
    - The co. has share of mind and share of emotion
    - Licensing revenue went from a couple hundred thousand dollars to \$1.5mm this year
    - Licensing will lag publishing revenue
  - Cooley: The magazine is sold in 70 countries
    - In 2007 it sold for \$250mm
      - Obviously it devolved before we bought it
  - CBRL was a straight flush but we have to work with the hand we're dealt at Maxim
  - Circulation has been flat
- Q: It seems like money raised at BH has gone into TLF. Can that cash come out?
  - Access to capital is not the concern.

- Holding co. will have to pay a lot higher prices for permanent holdings than we have to pay in the public market
- TLF has a 5 year lock on funds
- If an opportunity arises we will discuss a course of action with the board of directors
- A traditional fund would not have done something like the JPM-CBRL transaction
  - We did it to maintain the tax advantage for the holding co.
- Q: What were the discussions with the board regarding the licensing agreement? Have the Biglari name/pictures increased sales at SnS?
  - Cooley: It has to do with building a brand.
    - There have already been advantages we've seen with discussions between the CEO after whom the company is named
    - The brand is becoming valuable
  - Biglari: Any time you can stand behind a product and stand behind quality, it resonates
    - In the turnaround, we needed to make a commitment and that's what people see from the moment they walk in
    - We got a 40% increase in SSS because we made a value proposition
- Q: What are your thoughts on the overall market valuation and restaurant space valuation?
  - Romano's Macaroni Grill was for sale in '08 at a valuation of \$160mm
    - That was the market value of SnS at the time
    - Fast forward and the company was sold for \$50mm
      - A few days ago they announced that it was being sold for \$8mm
  - The restaurant industry is a cemetery with mines
    - Go to pay your respects and wind up becoming a permanent resident
    - You must be careful choosing the right brand
    - It requires a good jockey and won't drag the jockey along with it like KO
  - Interest in the sector is diametric to what it was a few years ago
  - Cooley: It's harder to find deals today than it was a few years ago
    - It's getting a little toppy in my opinion, but everyone has an opinion
- Q: Is support of existing franchisees sufficient, and will there be an environment where \$3.99 kids meals don't make sense?
  - We are the largest franchisee- there is complete alignment between us and franchisees
  - We are willing to sacrifice margin to get higher turnover and more profit
  - We are not asking someone to join with the expectation that the menu is going to change
    - Recently had a one pager made to express the guidelines that franchisees will follow
  - The brand is one vision one way. We can't have the same brand offering different products at different prices.
    - Join if you agree with our philosophy. Otherwise, don't
  - We want to keep our gross margins below 30% (higher than MCD's)

- Labor costs as a % of sales have declined since 2008 despite spending \$9mm more from minimum wage hikes
- Follow up Q: What's the value proposition to a franchisee/why would they choose SnS?
  - There are not many chains with 25 quarter over quarter SSS increases
    - SnS and Chipotle are it
  - Working on a project now to get an inline unit available for less than \$400k.
  - It has been the legacy franchisees that are the most vocal about any problems
- Q: Things have been going well, but what happens if things go bad at Maxim?
  - If we see unending losses by 2016, I have no intention of keeping a loser
  - Cooley: 90% of the employees at Maxim are new
    - These people were winners at their former jobs and they will be winners here
- Q: What explains the significant increase in SnS capital expenditures this year?
  - A refresh/reimaging of SnS units
    - Cost \$11.2mm in new fiscal year (\$8.7mm in old fiscal year)
    - This is maintenance capex that you have to do every few years
  - New units that will be leveraged for franchising
  - Executives at other companies don't know why their sales decline
    - Service, quality, and price are the pillars of value
      - There is causality between these things and SSS
  - MCD quarter pounder was \$5 and change in '08, SnS's equivalent offering was \$7.75
    - SnS has reduced price and now MCD is higher
- Q: What's the deal with the Tennessee law and what is your opinion of CBRL over the last couple quarters?
  - We've lost some battles but are winning the war
    - Our gain on investment has exceeded the profits that CBRL has made for all of its shareholders
      - That is unsustainable
  - CBRL founder grew the chain in a way that resonated with consumers
    - Real estate portfolio is among the best in the industry
    - In 1998, the company was earning \$460k per store
      - Company is not back to that point yet
  - Last year we likened our strategy to the Rumble in the Jungle [went 8 rounds] but it's starting to look more like the Thrilla in Manila [went 14 rounds].
  - [Biglari calls the CBRL CFO, who is seated in the back, to the mic for questions. He initially says that this isn't his meeting but comes to the mic anyway. Biglari asks about the new CBRL fusion concept.]
    - CBRL CFO: 'To quote a certain CEO and investor, you should do more thorough research.'
      - We've publicly discussed the concept quite a bit
    - Biglari: The best thing you can do is stop opening new stores and wasting money on new concepts

- CBRL CFO: 'I'll offer the observation that we've had four proxy contests, if you remove your votes, CBRL shareholders have voted 90 to 10 in favor of CBRL nominees
  - Biglari: Ridiculous to talk about the vote ex-the largest shareholder
    - The upshot of our ownership is that we get paid to wait, but should CBRL stumble, we will be there.
    - Hopefully the concepts won't cost too much money
- Q: Why should our BH shares owned by TLF be subject to a 25% performance fee?
  - I look to put TLF capital into the most attractive investments available
- Q: Seth Barkett: How do you and the BoD reconcile the conflicts of interest and self-dealing
  - There is no self-dealing
- Follow up Q: On behalf of all shareholder we would like to know about conflicts of interest
  - There are no conflicts of interest
- Q: How do the new reinsurance treaties change the business?
  - The combined ratio will move up if we take risk on the liability side
  - The reason we won't just start a company is because we haven't been involved in insurance for very long
    - We don't have the team
  - FG could become a small piece of a larger operation but we don't have a master strategy
- Q: Nick Swenson: Security laws require that you have policy and procedures with respect to how TLF shares are voted. Will you disclose those?
  - You've given your hit and run arguments
  - Go read Security Analysis, 2<sup>nd</sup> edition, page 600.
    - Wonderful chapter with discussion on proxy contests
- Follow up Q: TLF was a substantial part of your margin of victory.
  - This is not a Biglari Capital Corp. meeting
  - Everything that should be disclosed has been disclosed
- Q: Did you have an intention for the capital raised by the CBRL-JPM deal?
  - We don't discuss the universe of opportunities we see
  - We are willing to discuss CBRL because it's such a large part of the company
- Q: How did you guys [Biglari and Cooley] decide to team up?
  - Phil's ideas were his own and he was a good simplifier of complex concepts
    - He was familiar with value investing but not steeped in it
  - We can have discussions with no ego involved and share intellectual curiosity
  - Cooley: We are the type of people that would dread going to the beach and doing nothing for a week
- Q: How did the gift card float increase so much year over year?
  - There is some seasonality
  - Plus we have added new retailers
    - Sam's club has added several million in the last quarter

- Q: What is the timetable for franchisee openings and will you disclose franchise costs?
  - We did not disclose it this year because we did not have much of a change from last year
    - It's about 25% of G&A
  - The franchising dollar amount and percentage of G&A is expected to be lower this year
  - We have 270 locations committed and that will take some time
  - Shake shack has a fantastic operator. There aren't that many Alshayas around
  - Franchisee growth will continue
    - Probably 20-25 will open this year
- Q: How do you measure customer service in your stores and franchisee stores?
  - Complaints per 10,000 is a useful metric
    - Weak performance shows up in the numbers fairly quickly
  - We measure everything in our stores, down to the temperature of ice cream
  - We have a room in San Antonio that is set up like a control center with alerts
- Q: Are average sales at new franchisees higher than legacy franchisees?
  - New franchisees are the driver of growth
  - Newer units are much prettier, better organized, cost less, and do more
  - If you compare apples to apples, new ones do better than old ones
  - We try to get franchisees to focus on profits instead of margins
- Q: Rights offerings are akin to a property manager putting a gun to the head of a landlord and demanding money in exchange for rooms the property manager has seized. Will shareholders be able to vote on future rights offerings?
  - We can issue up to what is authorized before we have to vote on increasing the authorization
  - When it is customary for the BoD to vote on something, we don't put it up for shareholder vote
  - We don't expect another offering this year. It's an option that's available
  - You can take your right, sell them, and buy stock
    - Rights offerings don't dilute you if you do this
    - If you can't sell your rights, like the offerings at Pro-Dex, that is a problem
      - We have not structured our offerings this way
- Q: What are your opinions on the state of the Biglari reputation and will this inhibit the company's ability to find permanent holdings or sign up franchisees?
  - We don't believe there has been any damage to the reputation.
- Q: How do you maintain a competitive advantage at BH?
  - Restaurant industry is a jockey industry
    - If SnS brand were so good, why was the company almost bankrupt?
  - Maintain low costs and make sure they are all variable
- Q: What is the status of the supply chain for franchising?
  - We have the supply chain figured out in most places
    - Pakistan notwithstanding

- At this point we need to focus efforts on opening locations
  - In Europe, burgers are either dirt cheap or very expensive
- Q: With franchising coming to fruition, is 2016 expected to be a record year for SnS profits?
  - International franchising is going to lag as we have more to prove
- Q: My appraisal of the company's value was \$650mm when you put your incentive agreement in place. Didn't you transfer \$100mm from yourself to shareholders? [The same guy asked the same question last year]
  - Most of my compensation is from investments
  - A 6% hurdle seems quite high given interest rates
  - Fact is, it is pay for performance and if you don't make any money, I don't make any money
    - You say I'm taking from shareholders but how can I get paid without first making money for shareholders? [Biglari waits for a response, none is given]
    - If there is a loss, I have to make it back and then 6%
  - TLF fee is paid at the beginning of the year so volatility does not help me
  - It takes a very high return from TLF for us to earn what other funds earn
  - I did things that hurt my bonus like franchising and buying Maxim
    - Clearly I'm in it for the long haul
    - The conspiracy theories are crushed if you look at what has happened
  - If you think I'm stealing from you or cheating you, sell the stock
  - 'If I hadn't done well with my first company, I couldn't have started TLF. If I hadn't been successful with TLF, I couldn't have gone into Western Sizzlin. If I hadn't been successful with Western, I couldn't have gotten involved with Friendly's. If I hadn't been successful at Friendly's, I couldn't have gone onto SnS.'
    - We are results oriented
- Q: Could you disaggregate franchising revenue?
  - You have a couple of things going on like decommitments and unrealized royalties that build up (from a franchisee not being open enough months), but we aren't going to get into the minutia
- Q: If you get to 51% ownership, will you waive your management fee and be compensated by share price appreciation?
  - It's premature to talk about that because the actual ownership percentage is so far from what you're talking about
  - The greater the percentage of ownership, things will change
  - There are capitalists who work for free, but I'm not one of them
  - If you're looking for the next Berkshire, look elsewhere
    - Comparing BH and BRK is an insult to the man from Omaha
- Q: How do you foresee moving the value needle in the future with the CBRL stake?
  - We concentrate our portfolio of investments
    - We believe risk is about the individual and not the asset
      - It's a question of knowledge and understanding

- You can look at our track record
- Most people should diversify
  - Read Common Stocks and Uncommon Profits, chapter 9
- Q: Is there synergy potential between the different subsidiaries?
  - There is a natural tendency for people at the holding co. to want to get involved in the subsidiaries
    - We let the subsidiaries run themselves
    - We don't want management layers
  - It can make sense to glamorize a SnS opening with Maxim models or use SnS food trucks at Maxim events
  - We had Maxim models at the FG booth but it is completely up to the subsidiaries if they want to do this or not
- Q: What have you learned from Chipotle and Shake Shack?
  - The founder of Shake Shack grew up in St. Louis and was inspired by SnS
    - He is a fantastic operator, and we wish he had shown his gratitude in a different way
  - Every burger place is a competitor with us but we are at different price points
    - He is going after people with more disposable income
    - His approach makes sense. He wants 450 units and that seems reasonable
- Q: With respect to making a shake, it seems that soft serve is much easier to use than hand packed ice cream. Why not use soft serve? How did the organic burger available in NY turn out?
  - I don't understand the organic push. It's counterintuitive
  - We do not take advice from anyone on milkshakes
    - We are the kings of milkshakes
    - We sell 70mm per year- far more than anyone else
- Q: Why isn't it easier to expand into states without any SnS?
  - We are adding units to those places as we speak
  - I am not looking to compare us with others
    - Chipotle has done a fantastic job. It was doing well before we showed up and it still is doing well
  - Cooley: We are not interested in using our capital to open new locations. Our strategy is franchising
- Q: How do you split your time between domestic and international franchising?
  - I don't see those as mutually exclusive
- Q: How do you choose which products to license/how to rep the brand?
  - It's important what we license
  - We want everyone to know about SnS, even at the top of Mt. Everest
- Q: How is licensing doing? How are the microwaveable shakes doing?
  - Micro shakes are available but not at WalMart
  - We may disclosure franchising and licensing revenue in one line item in the future
- Q: Are there plans to install delivery at SnS?

- We are always exploring options
  - It is culturally required some places, like Kuwait
- Q: You said you sell 70mm shakes, how much do you make per shake and are you finding places to put the money to work?
  - 30% of our sales are shakes
  - Concentration makes our investment decisions binary
    - Either we invest heavily or we stay out
    - Maybe that's why we have a few small positions in companies to keep us busy
- Q: Is the effective tax rate in TLF the same as the holding company or First Guard?
  - They would be different because of state tax but they're pretty close to the same
- Q: Do you do reckless things like skydive?
  - I plead the 5<sup>th</sup>
  - Actuarially, I have 41 years to go.
  - Cooley: The BoD has a succession plan that we discuss every year
- Q: The burger industry is very crowded. Where is SnS's market share going to come from?
  - You are right, it is a CEO intensive business
  - Out edge is a low cost structure and emotional tie-in with the brand
  - I don't think you find a lot of competition from the other chains
    - These chains tend to attract bad management.
      - When someone gives guidance to the penny, you can be sure that the people below them are working to squeeze out the results
    - If you look under the hood of most companies, it's not good
  - Managing SnS is like a kayak
    - Business is fairly steady but when the boat rocks we adjust for it
      - Two years ago, business slowed down and we had to change some things
- Q: How do burger prices compare in Europe?
  - In France, a meal of ours is seven to eight euros.
    - Higher than MCD but very close
    - We are giving a different experience
      - Not just fast food but a fun and interesting experience
- Q: Do you have a sell price for CBRL and what does the CBRL-JPM transaction do?
  - The prepaid gives us the option to pay it off in shares
  - I don't care what the market does
    - I am a purist in the sense that I look at the company and what it can do
    - Every day is a decision day
  - If you double a dollar every day, in 30 days you have a billion dollars
    - If you take out tax every day, you have a few million
    - We are currently getting an interest free loan from the government
- Q: What are your views on Ray Dalio's principles?
  - They're great

- Q: What about Ken and Shawn Biglari?
  - They have been very important for getting international deals done
  - Cooley: We get more value from them than we pay them