

WESTERN SIZZLIN CORP
Form 10-K
April 15, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

- x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

OR

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 0-25366

WESTERN SIZZLIN CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

416 South Jefferson Street, Suite 600, Roanoke, Virginia

86-0723400

(I.R.S. Employer Identification No.)

24011

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(Address of principal executive offices)

(Zip Code)

(540) 345-3195

Registrant's telephone number, including area code Securities registered pursuant to Section 12(b) of the Act:

Title of each class
None

Name of each exchange on which registered
None

Securities registered pursuant to Section 12 (g) of the Act:

Common Stock

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Rule 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or informational statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregated market value of the Company's voting common stock held by non-affiliates, based upon the average bid and asked price as of June 30, 2007, was approximately \$14,827,396. For purposes of this computation, the registrant assumed that its Directors and Executive Officers were affiliates.

As of March 31, 2008, there were 2,696,625 shares, \$0.01 par value, of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for its Annual Meeting of the Stockholders are incorporated by reference in Part III, Items 10, 11, 12, 13, and 14.

WESTERN SIZZLIN CORPORATION
FORM 10-K
For the Fiscal Year Ended December 31, 2007

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We make forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Our actual results could vary materially from those expressed in our forward-looking statements.

When we use the words expect, anticipate, estimate, may, will, should, intend, plan, or similar expressions, we intend to identify forward-looking statements. Forward-looking statements also include the assumptions that underlie such statements. We assume no obligation to update any of our forward-looking statements.

You should not place undue reliance on these forward-looking statements because they depend on assumptions, data or methodology that may be incorrect or imprecise and we may not be able to realize them.

Part I

Item 1. Business

Western Sizzlin Corporation is a holding company owning subsidiaries engaged in number of diverse business activities. Our primary business activities are conducted through Western Sizzlin Franchise Corporation and Western Sizzlin Stores, Inc., which franchise and operate 122 restaurants in 20 states, including five Company-owned, 116 franchise restaurants, and one joint venture restaurant. We currently operate and/or franchise the following concepts: Western Sizzlin, Western Sizzlin Wood Grill, Western Sizzlin Express, Great American Steak & Buffet, and Quincy Steakhouses.

Financial decisions are centralized at the holding company level, and management of operating businesses is decentralized at the business unit level. Investment and all other capital allocation decisions are made for us and our subsidiaries by Mr. Sardar Biglari, Chairman and Chief Executive Officer. Our primary objective centers on achieving above-average returns on capital in pursuit of maximizing the eventual net worth of our stockholders.

Effective January 1, 2007, we restructured our operations into a holding company/subsidiary format whereby all operations are now conducted through wholly-owned subsidiaries. This restructuring is not anticipated to have any tax impact and will have no impact on our financial reporting as we will continue to report consolidated financial statements.

In April 2007, we formed Western Investments, Inc., a Delaware corporation and wholly-owned subsidiary to serve as the general partner of Western Acquisitions, L.P., a Delaware limited partnership that operates as a private investment fund. Through Western Investments, Mr. Biglari operates as the portfolio manager to the fund.

We seek to invest, at the holding company and through subsidiaries, including Western Acquisitions, L.P, in stocks of businesses at prices below their intrinsic business value. Our preferred strategy is to allocate a meaningful amount of capital in each investee, resulting in

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concentration. The carrying values of these investments are exposed to market price fluctuations, which may be accentuated by a concentrated equity portfolio. A significant decline in the price of major investments may produce a large decrease in our net earnings and our stockholders equity (See Note 6).

Western Investments, Inc. is the majority investor in Western Acquisitions, L.P., at December 31, 2007. During the third quarter ended September 30, 2007, we contributed cash along with holdings in the common stock of The Steak n Shake Company to Western Investments, Inc., which in turn contributed these assets to Western Acquisitions, L.P.

Western Investments' role as the general partner of Western Acquisitions, L.P. carries with it the obligation to manage the operations of the fund, and in this regard it will be assisted by a professional fund administrator. For serving as the fund's general partner, Western Investments may receive a monthly management fee equal to one-twelfth of 1% of the value of the capital account of each limited partner. It also may receive an annual incentive allocation equal to 20% of the portion of each limited partner's pro rata share of the fund's net profits for each fiscal year in excess of net losses allocated to each limited partner and carried forward from prior years. All or part of these fees may be waived by Western Investments. Limited partnership interests in the fund are either Class A or Class B. The classes are identical except that Class A interests must be held for two years, whereas Class B interests are locked-up for five years. Additionally, Western Investments will at the end of the five year period reimburse the holders of Class B interests for the first 30% of any

cumulative net losses they may suffer. This commitment carries significant risk. See Item 1.A. Risk Factors. As of December 31, 2007, Western Acquisitions, L.P. did not have any limited partners holding Class B interests.

Restaurant and Franchise Operations Overview

Restaurant Operations and Support

Our aim is to deliver a dining experience that exceeds customer expectations. Consistently providing high quality, flavorful food products with both a full line of entree offerings and an enhanced buffet bar offering can be a challenge. Our goal is not only to meet this challenge, but to exceed the guest expectation of both quality and service, and to offer a price point that the guest will perceive as an exceptional value.

There are several factors necessary for achieving our goal:

- Food Quality:
 - Our restaurants use high quality ingredients in all menu offerings. Additionally, all food preparation is done on premises, by either small batch or large batch cooking procedures. Guest flow determines which type will be used.
 - We strive to ensure that each recipe is prepared and served promptly to guarantee maximum freshness, appeal and that proper serving temperatures are maintained. We believe that our food preparation and delivery system enables us to produce higher quality and more flavorful food than is possible in other steak and buffet or cafeteria style restaurants.
- Menu Selection:

Our restaurants emphasize two traditional American style offerings:

- The first is the traditional family style steakhouse, which became popular during the 1960 s. Since that time, the primary red meat offering has grown extensively and now includes a vast array of chicken, pork, seafood and many other protein dishes.

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- The second is a full line of both hot & cold food buffet, which has become a very appealing option for our guests. Our rotating daily menu offerings, displayed on one of our many scatter bars in the buffet area, clearly demonstrate our home cooking flavor profile.

We believe that our extensive food offering provides the guest with delicious variety and a flavorful dining experience that will encourage them to visit our restaurants time after time.

- Price/Value Relationship:

We are committed to providing our guests with excellent price to value alternatives in the full-service casual dining restaurant sector and traditional steak and buffet restaurants. At our restaurants, the guests are provided with a choice of many different entree offerings and they can also choose to enjoy our all-you-care-to-eat unlimited food or buffet bar offerings. We believe the perceived price value is excellent, with lunch ranging between \$5.00 and \$9.75 and dinner ranging between \$7.00 and \$15.50. Additionally, our restaurants normally offer special reduced prices for senior citizens and children under 12 and other special promotions from time to time.

- Efficient Food Service and Delivery System:

The scatter bar format, food preparation methods and restaurant layout are all designed to efficiently serve a large number of guests, while enhancing the overall quality of the dining experience. In addition, preparing food in the proper amounts, serving it in several easily accessible areas (scatter bars) and closely monitoring consumption will shorten guest lines, increase frequency of table turns, improve over-all quality and reduce waste; thereby increasing guest satisfaction and

restaurant level profitability. Our restaurants range in size from approximately 5,200 square feet to 12,000 square feet. A description of these properties is provided in Item 2.

Site Selection and Construction

In selecting new restaurant locations, we consider target population density, local competition, household income levels and trade area demographics, as well as specific characteristics, including visibility, accessibility, parking capacity and traffic volume. An important factor in site selection is the convenience of the potential location to both lunch and dinner guests and the occupancy cost of the proposed site. We also take into account the success of other chain restaurants operating in the area.

Potential site locations are identified by a potential franchisee and/or corporate personnel, consultants and independent real estate brokers. Our executive management team will approve or disapprove any proposed restaurant site. The majority of restaurants are free-standing but some restaurants are developed in other formats such as strip centers.

Historically when a restaurant has been built in an existing facility, renovation and construction has taken approximately 60 to 120 days after the required construction permits have been obtained. New construction of free-standing restaurants requires a longer period of time and can range from 120 to 180 days. Also, when obtaining a construction permit, we have generally experienced a waiting period ranging from approximately 20 to 90 days.

Restaurants are constructed by outside general contractors. We expect to continue this practice for the foreseeable future.

Restaurant Management and Employees

The management staff of a typical restaurant consists of one General Manager, one Assistant General Manager and one or two Associate Managers. Individual restaurants typically employ between 40 and 80 non-management hourly employees (a mix of both part-time and full-time workers), depending on restaurant size and sales volume.

The General Manager of a restaurant has responsibility for the day-to-day operation of a restaurant, acts independently to maximize restaurant performance, and follows company-established management policies. The General Manager makes personnel decisions and determines orders for produce and dairy products, as well as, centrally contracted food items and other supplies.

Recruiting

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We attempt to attract and train high quality employees at all levels of restaurant operations. Generally, restaurant management is either recruited from outside the company and has had significant prior restaurant experience or has been promoted through the system as experience levels increased. As we continue to grow, our management will continue to recruit restaurant management personnel from among non-management employees within our system and supplement these resources through outside hiring.

Management Training

We have implemented strict operating standards. We maintain a strong standardized training process which plays a critical role in maintaining operational propriety. All management employees, including Assistant Managers, regardless of former experience, participate in a six to eight week formal course of training. Periodically, additional training is provided during each calendar year through a series of two to three day seminars, to provide the most current information on a variety of topics including sales building techniques, labor controls and food cost management. Non-management employees are generally trained at the local restaurant site.

Purchasing

In 2004, we negotiated a national, five-year contract with a broadline distributor and one to twelve month agreements with other vendors, as well. This allows us to maximize our buying power based on volume and also works towards our goals of system-wide consistency. We utilize velocity reports supplied by our various distributors to look for opportunities to consolidate our purchases resulting in cost of food savings. Our stores are divided into areas based on

geographical location. While each store places their own orders with the various distributors, the most successful stores are the ones who support the areas and use the volume of the combined buying power to be as economically efficient as possible.

Hours of Operation

Our restaurants are open seven days a week, typically from 11:00 a.m. to 10:00 p.m.

Franchise Operations

Our standard franchise agreement has a 20-year term, with one ten-year renewal option. It generally provides for a one-time payment to us of an initial franchise fee and a continuing royalty fee based on gross sales. We collect weekly and monthly sales reports from our franchisees as well as periodic and annual financial statements.

Each franchisee is responsible for selecting the location for its restaurant, subject to our approval. We consider such factors as demographics, competition, traffic volume and patterns, parking, site layout, size and other physical characteristics in approving proposed sites.

Franchisees must operate their restaurants in compliance with our operating and recipe manuals. Franchisees are not required to purchase food products or other supplies through our suppliers, but are required to purchase proprietary products from us. Each franchised restaurant must have a designated General Manager and Assistant Manager who have completed our six-week manager training program or who have been otherwise approved by us. For the opening of a restaurant, we provide consultation and make our personnel generally available to a franchisee. In addition, we send a team of personnel to the restaurant for up to two weeks to assist the franchisee and its managers in the opening, the initial marketing and training effort, as well as the overall operation of the restaurant.

We may terminate a franchise agreement for a number of reasons, including a franchisee's failure to pay royalty fees when due, failure to comply with applicable laws, or repeated failure to comply with one or more requirements of the franchise agreement. Many state franchise laws limit our ability to terminate or refuse to renew a franchise. A franchisee may terminate a franchise agreement and continue to operate the restaurant as a competitive concept by paying liquidated damages to us. We do not anticipate that the termination of any single franchise agreement would have a materially adverse effect on our operations. Termination by a multiple-unit franchisee of several franchise agreements for various locations could, however, have a materially adverse effect on our operations.

Our franchise agreement contains provisions that prohibit franchisees from disclosing proprietary information about our restaurant operating system. Our standard franchise agreement also contains non-competition provisions that, for the duration of the agreement and for one or two years following termination, prohibit a franchisee from directly or indirectly competing with us or soliciting employees to leave us. There is no assurance that these contractual provisions will effectively prevent the appropriation by franchisees of business opportunities and proprietary information. More discussion is contained in the caption Government Regulation.

Marketing and Promotion

Marketing and operations work hand-in-hand for all of our company concepts where a shared mutual vision provides value to the guest through hard work, quality and high standards. We know that communication plays a strong role in the fulfillment of our goals.

The Advertising Development and Research Fund or ADRF, financed through vendor support and member dues, is our franchisee-controlled graphic art design/marketing agency. It is incorporated under the name WSI ADRF, Inc.

ADRF creates, designs and produces each marketing campaign for the company and our franchisees. Production includes several major marketing campaigns annually in addition to menus, table tents, posters, indoor and outdoor signage, gift certificates and other marketing tools.

The marketing effort is communicated through a vast system of printed materials such as a corporate newsletter, internet webpages, training manuals, tapes and videos.

The marketing department is primarily self-sufficient in production capabilities with some of the most sophisticated

computer and graphic equipment available. ADRF is staffed by professionals experienced in all phases of marketing, graphics / design, and communications. Their efforts have produced and coordinated promotions that include national sweepstakes campaigns, television commercials, national convention materials and training videos.

The coordinated efforts of ADRF, area field consultants, training instructors, corporate personnel, franchise owners, managers and the entire system of operators share in the ongoing success of marketing programs. Our programs utilize virtually all types of media including billboards, newspapers, television and radio.

Restaurant Industry and Competition

The restaurant industry is extremely competitive. We compete on the basis of the quality and value of food products offered, price, service, ambiance and overall dining experience. Our competitors include a large and diverse group of restaurant chains and individually owned restaurants. The number of restaurants with operations generally similar to ours has grown considerably in the last several years. We believe competition among this style of restaurant is increasing.

In addition, our business is affected by changes in consumer tastes, national, regional and local economic conditions and market trends. The performance of individual restaurants may be affected by factors such as traffic patterns, demographic considerations and the type, number and location of competing restaurants. Our significant investment in, and long-term commitment to, each of our restaurant sites limits our ability to respond quickly or effectively to changes in local competitive conditions or other changes that could affect our operations. Our continued success is dependent to a substantial extent on our reputation for providing high quality and value and this reputation may be affected not only by the performance of company-owned restaurants but also by the performance of franchisee-owned restaurants over which we have limited control.

Government Regulation

Our business is subject to and affected by various federal, state and local laws. Each restaurant must comply with state, county and municipal licensing and regulation requirements relating to health, safety, sanitation, building construction and fire prevention. Difficulties in obtaining or failure to obtain required licenses or approvals could delay or prevent the development of additional restaurants. We have not experienced significant difficulties in obtaining such licenses and approvals to date.

We are subject to Federal Trade Commission (FTC) regulation and various state laws that regulate the offer and sale of franchises. The FTC requires us to provide prospective franchisees with a franchise offering circular containing prescribed information about us and our franchise operations. Some states in which we have existing franchises and a number of states in which we might consider franchising regulate the sale of franchises. Several states require the registration of franchise offering circulars. Beyond state registration requirements, several states regulate the substance of the franchisor-franchisee relationship and, from time to time, bills are introduced in Congress aimed at imposing federal registration on franchisors. Many of the state franchise laws limit, among other things, the duration and scope of noncompetition and termination provisions of franchise agreements.

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Our restaurants are subject to federal and state laws governing wages, working conditions, citizenship requirements and overtime. From time-to-time, federal and state legislatures increase minimum wages or mandate other work-place changes that involve additional costs for our restaurants. There is no assurance that we will be able to pass such increased costs on to our guests or that, if we were able to do so, we could do so in a short period of time.

Trademarks

We believe our rights in our trademarks and service marks are important to our marketing efforts and a valuable part of our business. Following are marks that are registered for restaurant services on the Principal Register of the U.S. Patent and Trademark Office: Western Sizzlin , Western Sizzlin Steak House , Western , Sizzlin , Western Sizzlin Cow , Western Sizzlin Steak & More , Western Sizzlin County Fair Buffet and Bakery , Flamekist , Marshall , Gun Smoke , Six Shooter , Big Tex , Dude , Trailblazer , Ranger , Cheyenne , Colt 45 , Cookin' What Amn , American Steak and Buffet Company , Great American Buffet , Western Sizzlin Wood Grill and Buffet , and Western Sizzlin Wood Grill .

Employees

As of December 31, 2007, we employed approximately 260 persons, of whom approximately 227 were restaurant employees, 19 were restaurant management and supervisory personnel, and 14 were corporate personnel. Restaurant employees include both full-time and part-time workers and all are paid on an hourly basis. None of our employees is covered by a collective bargaining agreement and we consider our employee relations to be good.

Item 1A. Risk Factors

We are dependent on key personnel.

We believe that our success depends in part on the services of Sardar Biglari, our Chairman, President and Chief Executive Officer, and Robyn B. Mabe, Vice President and Chief Financial Officer. The loss of the services of Mr. Biglari or Mrs. Mabe could have a material adverse effect upon our business, financial condition and results of operations. Qualified replacements may not be available in a timely manner, if at all. Our continued growth will also depend on our ability to attract and retain additional skilled management personnel.

Our stock price could be volatile.

Fluctuations in our stock price may result from general market conditions, perceived changes in the underlying characteristics of our business, and the relative price of competing investments. The volume of trading in the market for our common stock is typically very limited. As a consequence, liquidating your investment could cause a decline in our stock price. Because of changes in the balance of buy and sell orders, notwithstanding other relevant factors, the price of our common stock can fluctuate for reasons unrelated to the performance of our business.

We are controlled by a few stockholders.

Two stockholders, Sardar Biglari, our Chairman and Chief Executive Officer, and Jonathan Dash, a director, beneficially own or exercise voting power over approximately 61% of our total common stock. In particular, Mr. Biglari controls approximately 35% and Mr. Dash approximately 26% of our outstanding common stock. Further details on their respective holdings are reflected in their Schedules 13D, as amended, which are filed with the SEC. Were these stockholders to agree to act in concert, they would have the ability to control or significantly influence all matters requiring the approval of our stockholders, including the election of its directors. Sale of a substantial number of shares of our common stock by these principal stockholders in the public market could substantially reduce the prevailing market price of the common stock.

Our Board of Directors has recently undergone significant change.

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In November 2005, we added three new members to its Board of Directors, namely Sardar Biglari, Philip L. Cooley and Paul D. Sonkin. Subsequently, in March 2006, six of the incumbent directors, Paul C. Schorr, III (former Chairman), A. Jones Yorke, J. Alan Cowart, Jr., Pat Vezertzis, Jesse M. Harrington and Roger D. Sack, resigned from the Board. At that same time Mr. Sonkin indicated that he would not stand for reelection at the 2006 annual meeting of stockholders. He ultimately resigned prior to the annual meeting. Jonathan Dash was elected to the Board in March 2006. Thomas M. Hontzas resigned from the Board in August 2006. Kenneth R. Cooper was elected to the Board in February 2007 and Martin S. Fridson was elected to the Board in November 2007. While we believe that the Board of Directors as presently constituted with Sardar Biglari as Chairman, Philip L. Cooley as Vice Chairman and Directors Titus W. Greene, Jonathan Dash, Kenneth R. Cooper and Martin S. Fridson, will function at least as well as the Board had done previously, there is no guarantee this will be the case. The failure of the Board to function adequately together would have a material adverse effect on our business. This could result in an adverse impact on our financial condition, results of operations and stock price.

We recently formed a new wholly-owned subsidiary, Western Investments, Inc., to serve as the general partner of a private investment limited partnership, Western Acquisitions, L.P. Western Investments will bear the first 30% of any cumulative net losses otherwise allocable to the capital accounts of certain limited partners.

In April 2007, we formed Western Investments, Inc., a Delaware corporation, as a wholly-owned subsidiary. Western Investments, Inc. is the general partner of Western Acquisitions, L.P., a Delaware limited partnership also formed in April 2007. The purpose of Western Acquisitions, L.P. is to invest primarily in equity securities of U.S. publicly traded companies. Sardar Biglari, our Chairman, Chief Executive Officer and President, will manage the portfolio. Western

Investments, Inc. will bear the first 30% of any cumulative net losses otherwise allocable to the capital accounts of limited partners holding Class B interests of Western Acquisitions, L.P. In the event that Western Investments, Inc. has insufficient resources to fund this commitment, it may be necessary for us to make a capital contribution to keep that company from defaulting on its obligation. Such an event could potentially have a material adverse effect on our financial position and prevents us from using the funds provided to Western Investments, Inc. in other areas. As of the date of this filing, Western Acquisitions, L.P. did not have any limited partners holding Class B interests.

We recently formed a new wholly-owned subsidiary, Western Properties, Inc. to serve as the general partner of a private investment limited partnership, Western Real Estate, L.P., which had no limited partners in 2007 but intends to operate as a private real estate investment partnership.

In December 2007, we formed Western Properties, Inc., a Delaware corporation, as a wholly-owned subsidiary. Western Properties is the general partner of Western Real Estate, L.P., a Delaware limited partnership also formed in December 2007. There were no limited partners in the partnership at December 31, 2007 and the sole activity of these entities in 2007 was the purchase by the limited partnership of 23 acres of real property in Bexar County, Texas from an unaffiliated third party. It is the intention of Western Real Estate, L.P., to operate as a private limited partnership investing in real estate however this venture is in the formative stages and there is no guarantee that it will be successful.

We are dependent on one key person for investment and capital allocation decisions.

Investment decisions and all major capital allocation decisions are made for us and our subsidiaries, including Western Acquisitions, by Sardar Biglari, our Chairman of the Board of Directors, Chief Executive Officer and President. Although there are limitations on Mr. Biglari's authority at the parent company level and our Board of Directors monitors his investment and capital allocation decisions, there is risk in having concentrated decision-making authority. Mr. Biglari's decisions could either independently or in the aggregate involve amounts that are material to our business. Additionally, if for any reason the services of Mr. Biglari were to become unavailable, there could be a material adverse effect on our business, since he is singularly responsible for these decisions.

Our investments in marketable securities, including through Western Acquisitions L.P., are highly concentrated.

Our investments in marketable securities, including through Western Acquisitions, L.P., are highly concentrated. A decline in the market value of these investments may result in a decrease in our stock price.

Our investment activities, including through Western Acquisitions, L.P., may involve the purchase of securities on margin.

We may purchase securities on margin in connection with our investment activities, including through Western Acquisitions, L.P. If we do so, a significant decrease in the value of the securities that collateralize the margin line of credit could result in a margin call. If we do not have sufficient cash available from other sources in the event of a margin call, we may be required to sell those securities at a time when we would prefer not to sell them.

Our investment activities could require registration as an Investment Company.

While we have historically been principally engaged in franchising and operating restaurants, our recent investment activities could bring us within the definition of an investment company and require us to register as an investment company under the Investment Company Act of 1940. The Board of Directors has adopted a policy requiring management to restrict the Company's operations and investment activities to avoid becoming an investment company, until and unless the Board approves otherwise. We do not intend to change our principal business and the Board has not approved otherwise. Although we do not presently intend to change its principal business, and the Board has not approved any such change, we have expanded our investment activities, and may decide in the future to register as an investment company under the Investment Company Act. Also, under certain circumstances, if we are successful in investment activities, then we may inadvertently fall within the definition of an investment company, in which event we may be required to register as an investment company.

Notwithstanding our Board policy, if our investment activities inadvertently result in our being determined to be an investment company and we fail to register as an investment company, we might be unable to enforce contracts with third parties, and third parties could seek rescission of transactions with us undertaken during the period that we were an

unregistered investment company, subject to equitable considerations set forth in the Investment Company Act. In addition, we might be subject to monetary penalties or injunctive relief, or both, in an action brought against us by the SEC.

If we decide to register as an investment company, then we would become subject to various provisions of the Investment Company Act and the regulations adopted under such Act, which are very extensive and could adversely affect our operations. For example, we might be prohibited from entering into or continuing transactions with certain of our affiliates.

We are experiencing a decline in our franchise base.

We have experienced steady declines in our existing franchise base for the past several years. Since January 1, 2005, we had a total of 35 closures and currently have a total of 116 franchised restaurants. Of the 35 closed restaurants the majority were Western Sizzlin brand restaurants. The average annual sales of our franchised restaurants are approximately \$1.6 million. The average annual sales of the closed restaurants were \$1.0 million or less. The closures of franchised restaurants were caused by their operating at a competitive disadvantage which stemmed from such factors as location, facility, lack of reinvestment and mismanagement, among others factors. There is no guarantee that these reasons will be eliminated. Moreover, these closures occurred during generally favorable economic conditions and it is possible that this trend could accelerate in the event of an economic downturn or recession. While we are striving to reverse this trend by revitalizing our franchise models, there is no assurance that we will be successful in doing so and as a result our franchise base may continue to decline regardless of the economic environment.

Our restaurants operate in a highly competitive environment.

Our restaurants, both franchised and Company-owned, operate in a highly competitive industry comprised of a large number of restaurants, including national and regional restaurant chains and franchised restaurant operations, as well as locally-owned, independent restaurants. Price, restaurant location, food quality, service and attractiveness of facilities are important aspects of competition. The competitive environment is often affected by factors beyond a particular restaurant management's control, including changes in the public's taste and eating habits, population and traffic patterns and economic conditions. New competitors may emerge at any time. We may not be able to compete successfully against our competitors in the future. Competition may have a material adverse effect on our operations or earnings.

We are highly dependent on attracting and retaining qualified employees while also controlling labor costs.

We are extremely dependent upon the availability of qualified restaurant personnel. Availability of staff varies widely from location to location. If restaurant management and staff turnover trends increase, we would suffer higher direct costs associated with recruiting and retaining replacement personnel. We could suffer from significant indirect costs, including restaurant disruptions due to management changeover and potential delays in new store openings due to staff shortages. Competition for qualified employees exerts upward pressure on wages paid to attract personnel, resulting in higher labor costs, together with greater expense to recruit and train them. Many of our employees are hourly workers whose wages are likely to be impacted by an increase in the federal or state minimum wage. An increase in the minimum wage may require an increase or create pressure to increase the pay scale for our employees. A shortage in the labor pool or other general inflationary pressures or changes could also increase our labor costs.

We are dependent upon the timely delivery of fresh ingredients.

Our restaurant operations are dependent on timely deliveries of fresh ingredients, including fresh produce, dairy products and meat. The cost, availability and quality of the ingredients we use to prepare our food are subject to a range of factors, many of which are beyond our control. Fluctuations in weather, supply and demand and economic and political conditions could adversely affect the cost, availability and quality of our ingredients. Historically, when operating expenses increased due to inflation or increases in food costs, we generally have been able to offset these higher costs by increasing our menu prices. We may not be able to recover increased costs in the future because competition may limit or even prohibit such future increases. If the variety or quality of our food products declines due to the lack or lower quality of our ingredients or due to interruptions in the flow of fresh ingredients and similar factors, customer traffic may decline and negatively affect our sales.

General economic factors may adversely affect our results of operations.

National, regional, and local economic conditions, such as recessionary economic cycles or a worsening economy, could adversely affect disposable consumer income and consumer confidence. Unfavorable changes in these factors or in other business and economic conditions affecting our customers could reduce customer traffic in some or all of our restaurants, impose practical limits on our pricing and increase our costs. Any of these factors could lower our profit margins and have a material adverse affect on our results of operations. The impact of inflation on food, beverages, labor, utilities and other aspects of our business can negatively affect our results of operations. Although we attempt to offset inflation through periodic menu price increases, cost controls and incremental improvement in operating margins, we may not be able to completely do so. This may negatively affect our results of operations.

We face the risk of adverse publicity and litigation relating to food-borne illness, employment and other matters that could have a material adverse affect on our business and financial performance.

We may be the subject of complaints or litigation from customers alleging illness, injury or other food quality, health or operational concerns. While the risk of food-borne illness is real, whether it results from improper operations, new diseases or from chemicals in certain food products, the risk would generally only affect a limited number of our restaurants. As soon as any food issues became known to us, those food items that were potentially at risk would be no longer served to customers.

While the risk of food-borne illness or injury would likely be localized, the risk of the adverse publicity that might result from such an incident is more generalized and accordingly much greater. The general public's response to adverse publicity relating to our restaurant brands could materially adversely affect a significant number of our restaurants. This could be true whether the allegations underlying the adverse publicity are valid or whether we are liable.

Furthermore, more generalized health concerns about the consumption of beef or chicken due to reported incidents of diseases such as Bovine Spongiform Encephalopathy (mad cow disease) or Avian Influenza (bird flu) could lead to changes in customer preferences, reduce consumption of our products and adversely affect our financial performance. These events could also reduce the available supply of beef or chicken or significantly raise the prices of beef or chicken.

In addition, we are subject to employee claims alleging injuries, wage and hour violations, discrimination, harassment or wrongful termination. In recent years, a number of restaurant companies have been subject to lawsuits, including class action lawsuits, alleging violations of federal and state law regarding workplace, employment and similar matters. A number of these lawsuits have resulted in the payment of substantial damages by the defendants. Regardless of whether any claims against us are valid or whether we are ultimately determined to be liable, claims may be expensive to defend and may divert time and money aw