

WESTERN SIZZLIN CORP  
Form 10-Q  
November 09, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

## FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006, or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

## Western Sizzlin Corporation

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**86-0723400**

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

**1338 Plantation Road Roanoke, Virginia**

(Address of Principal Executive Offices)

**24012**

(Zip Code)

**(540) 345-3195**

(Registrant's Telephone Number Including Area Code)

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 whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.) (Check one):

Large Accelerated Filer                       Accelerated Filer                       Non-Accelerated Filer

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

As of November 9, 2006, there were 1,191,850 shares of common stock outstanding.

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Western Sizzlin Corporation

Form 10-Q

Nine Months Ended September 30, 2006

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**PART I. FINANCIAL INFORMATION****WESTERN SIZZLIN CORPORATION**

## Consolidated Balance Sheets

September 30, 2006 and December 31, 2005

|  | September 30,<br>2006<br>(unaudited) | December 31,<br>2005 |
|--|--------------------------------------|----------------------|
| <b>Assets</b>  |                                      |                      |
| Current assets:  |                                      |                      |
| Cash and cash equivalents  | \$ 124,361                           | \$ 1,664,848         |
| Short-term investments   |                                      | 260,069              |
| Trade accounts receivable, net of allowance for doubtful accounts of \$464,692 in 2006 and \$454,458 in 2005                               | 754,535                              | 910,776              |
| Current installments of notes receivable   | 217,700                              | 212,187              |
| Income tax receivable  | 246,818                              | 17,923               |
| Insurance receivables  |                                      | 1,029,954            |
| Other receivables  | 65,100                               | 128,375              |
| Inventories  | 86,254                               | 83,506               |
| Prepaid expenses   | 238,568                              | 292,721              |
| Deferred income taxes  | 205,224                              | 226,736              |
| Total current assets   | 1,938,560                            | 4,827,095            |
| Notes receivable, less allowance for doubtful accounts of \$157,871 in 2006 and \$119,126 in 2005, excluding current installments          | 849,430                              | 876,426              |
| Property and equipment, net of accumulated depreciation of \$3,778,563 in 2006 and \$3,690,965 in 2005                                     | 2,366,182                            | 1,887,450            |
| Investment in marketable security (Note 4)   | 4,950,013                            |                      |
| Franchise royalty contracts, net of accumulated amortization of \$8,036,266 in 2006 and \$7,563,545 in 2005                                | 1,418,165                            | 1,890,887            |
| Goodwill   | 4,310,200                            | 4,310,200            |
| Financing costs, net of accumulated amortization of \$182,822 in 2006 and \$136,446 in 2005  | 17,389                               | 63,764               |
| Investment in unconsolidated joint venture   | 240,525                              | 308,382              |
| Deferred income taxes  | 14,056                               | 576,467              |
| Asset held for sale  | 300,000                              | 300,000              |
| Other assets, net  | 116,693                              | 435,161              |
|  | \$ 16,521,213                        | \$ 15,475,832        |
| <b>Liabilities and Stockholders Equity</b>   |                                      |                      |
| Current liabilities:   |                                      |                      |
| Current installments of long-term debt   | \$ 209,814                           | \$ 1,487,964         |
| Accounts payable   | 716,962                              | 523,939              |
| Due to broker (Note 4)   | 1,693,084                            |                      |
| Accrued expenses and other   | 315,038                              | 814,005              |
| Total current liabilities  | 2,934,898                            | 2,825,908            |
| Long-term debt, excluding current installments   | 727,401                              | 848,319              |
| Other long-term liabilities  | 63,066                               | 42,087               |
| Commitments and contingencies (Note 9)   |                                      |                      |
| Stockholders equity:   |                                      |                      |
| Common stock, \$.01 par value. Authorized 2,000,000 shares; 1,191,850 issued and outstanding shares in 2006 and 1,188,850 in 2005 (Note 2) | 11,919                               | 11,889               |
| Additional paid-in capital   | 8,748,445                            | 8,681,775            |
| Retained earnings  | 3,299,909                            | 3,065,854            |
| Accumulated other comprehensive income unrealized holding gains, net of taxes  | 735,575                              |                      |
| Total stockholders equity  | 12,795,848                           | 11,759,518           |
|  | \$ 16,521,213                        | \$ 15,475,832        |

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See accompanying notes to consolidated financial statements.

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## WESTERN SIZZLIN CORPORATION

Consolidated Statements of Income  
(Unaudited)

|   | Three Months<br>Ended September 30 |                   | Nine Months<br>Ended September 30 |                   |
|---|------------------------------------|-------------------|-----------------------------------|-------------------|
|   | 2006                               | 2005              | 2006                              | 2005              |
| <b>Revenues:</b>  |                                    |                   |                                   |                   |
| Company-operated restaurants                                | \$ 3,393,679                       | \$ 3,655,713      | \$ 9,971,290                      | \$ 11,629,512     |
| Franchise operations  | 1,092,221                          | 1,156,042         | 3,376,985                         | 3,571,541         |
| <b>Total revenues</b>                                       | <b>4,485,900</b>                   | <b>4,811,755</b>  | <b>13,348,275</b>                 | <b>15,201,053</b> |
| <b>Costs and expenses:</b>                                  |                                    |                   |                                   |                   |
| Company-operated restaurants food, beverage and labor costs | 2,365,806                          | 2,536,402         | 7,098,664                         | 8,270,047         |
| Restaurant occupancy and other                              | 704,991                            | 649,308           | 1,877,279                         | 2,025,361         |
| Subleased properties  | 106,508                            | 40,105            | 251,158                           | 173,472           |
| Franchise operations direct support                         | 262,694                            | 277,932           | 887,340                           | 868,627           |
| Corporate expenses  | 578,986                            | 670,049           | 1,843,139                         | 2,161,724         |
| Depreciation and amortization                               | 267,838                            | 262,104           | 791,819                           | 811,078           |
| Closed store expense  |                                    |                   |                                   | 350,279           |
| Gain on settlement of insurance claims                      |                                    |                   |                                   | (220,351 )        |
| <b>Total costs and expenses</b>                             | <b>4,286,823</b>                   | <b>4,435,900</b>  | <b>12,749,399</b>                 | <b>14,440,237</b> |
| <b>Income from operations</b>                               | <b>199,077</b>                     | <b>375,855</b>    | <b>598,876</b>                    | <b>760,816</b>    |
| <b>Other income (expense):</b>                              |                                    |                   |                                   |                   |
| Interest expense  | (30,057 )                          | (63,511 )         | (108,404 )                        | (221,428 )        |
| Loss on early extinguishment of long term debt              |                                    |                   | (92,535 )                         |                   |
| Interest income   | 16,343                             | 19,021            | 53,443                            | 53,215            |
| Other   | (6,483 )                           | (2,450 )          | 13,101                            | 22,992            |
| Equity in loss of joint venture                             | (29,629 )                          |                   | (67,857 )                         |                   |
|   | (49,826 )                          | (46,940 )         | (202,252 )                        | (145,221 )        |
| <b>Income before income tax expense</b>                     | <b>149,251</b>                     | <b>328,915</b>    | <b>396,624</b>                    | <b>615,595</b>    |
| <b>Income tax expense:</b>                                  |                                    |                   |                                   |                   |
| Current   |                                    | (538 )            |                                   | 25,557            |
| Deferred  | 64,600                             | 125,905           | 162,569                           | 211,046           |
| <b>Total income tax expense</b>                             | <b>64,600</b>                      | <b>125,367</b>    | <b>162,569</b>                    | <b>236,603</b>    |
| <b>Net income</b>   | <b>\$ 84,651</b>                   | <b>\$ 203,548</b> | <b>\$ 234,055</b>                 | <b>\$ 378,992</b> |
| <b>Earnings per share (Note 3):</b>                         |                                    |                   |                                   |                   |
| Basic   | \$ .07                             | \$ .17            | \$ .20                            | \$ .32            |
| Diluted   | \$ .07                             | \$ .17            | \$ .20                            | \$ .32            |

See accompanying notes to consolidated financial statements

**WESTERN SIZZLIN CORPORATION**

Consolidated Statement of Changes in Stockholders' Equity

Nine Months Ended September 30, 2006

(Unaudited)

|  | <b>Common Stock<br/>Shares</b> | <b>Dollars</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> | <b>Total</b>  |
|--|--------------------------------|----------------|---|------------------------------|---|---------------|
| Balances, December 31,<br>2005                                 | 1,188,850                      | \$ 11,889      | \$ 8,681,775                              | \$ 3,065,854                 | \$  | \$ 11,759,518 |
| Net income   |                                |                |   | 234,055                      |   | 234,055       |
| Change in unrealized<br>holding gains, net of taxes            |                                |                |   |                              | 735,575   | 735,575       |
| Comprehensive income   |                                |                |   |                              |   | 969,630       |
| Compensation expense<br>associated with stock options<br>plans |                                |                | 39,100                                    |                              |   | 39,100        |
| Stock options exercised  | 3,000                          | 30             | 27,570                                    |                              |   | 27,600        |
| Balances, September 30,<br>2006                                | 1,191,850                      | \$ 11,919      | \$ 8,748,445                              | \$ 3,299,909                 | \$ 735,575  | \$ 12,795,848 |

See accompanying notes to consolidated financial statements.

## WESTERN SIZZLIN CORPORATION

## Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2006 and 2005

(Unaudited)

|  | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|--|--------------|
|  | <b>2006</b>                                | <b>2005</b>  |
| <b>Cash flows from operating activities:</b>   |  |              |
| Net income   | \$ 234,055                                 | \$ 378,992   |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |  |              |
| Depreciation and amortization of property and equipment                                  | 319,098                                    | 324,726      |
| Amortization of franchise royalty contracts  | 472,722                                    | 472,722      |
| Write off of financing costs related to early extinguishment of long term debt           | 29,699                                     |              |
| Amortization of financing costs  | 16,676                                     | 13,630       |
| Loss on sale/disposal of property and equipment  | 57,717                                     | 359,776      |
| Gain from fire casualty  |  | (220,351 )   |
| Cash received from exercise of stock options   | 27,600                                     |              |
| Common stock related to termination of Franchise Agreement                               |  | (15,000 )    |
| Provision for doubtful accounts  | 80,000                                     | 100,320      |
| Share based compensation   | 39,100                                     |              |
| Equity in loss of unconsolidated joint venture   | 67,857                                     |              |
| Provision for deferred income taxes  | 162,570                                    | 211,046      |
| <b>(Increase) decrease in:</b>   |  |              |
| Trade accounts receivable and notes receivable   | 97,724                                     | 25,561       |
| Income tax receivable  | (228,895 )                                 |              |
| Insurance receivable business interruption   | 244,961                                    |              |
| Other receivables  | 63,275                                     | (117,377 )   |
| Inventories  | (2,748 )                                   | 31,856       |
| Prepaid expenses   | 54,153                                     | 22,322       |
| Other assets   | (59,987 )                                  | (357,607 )   |
| <b>Increase (decrease) in:</b>   |  |              |
| Accounts payable   | 193,023                                    | (409,016 )   |
| Accrued expenses   | (498,967 )                                 | (597,415 )   |
| Other long-term liabilities  | 20,979                                     | (14,841 )    |
| Net cash provided by operating activities  | 1,390,612                                  | 209,344      |
| <b>Cash flows from investing activities:</b>   |  |              |
| Short-term investments   | 260,069                                    | (3,802 )     |
| Additions to property and equipment  | (479,892 )                                 | (180,909 )   |
| Purchase of marketable security  | (2,100,000 )                               |              |
| Proceeds from sale of property   | 2,800                                      | 179,757      |
| Proceeds from fire casualty  | 784,992                                    | 652,964      |
| Net cash (used in) provided by investing activities                                      | (1,532,031 )                               | 648,010      |
| <b>Cash flows from financing activities:</b>   |  |              |
| Payments on long-term debt   | (1,399,068 )                               | (1,059,761 ) |
| Net cash used in financing activities  | (1,399,068 )                               | (1,059,761 ) |
| Net decrease in cash and cash equivalents  | (1,540,487 )                               | (202,407 )   |
| Cash and cash equivalents at beginning of period   | 1,664,848                                  | 2,105,751    |
| Cash and cash equivalents at end of period   | \$ 124,361                                 | \$ 1,903,344 |

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Supplemental disclosure of cash flow information:

|                            |            |            |
|----------------------------|------------|------------|
| Cash payments for interest | \$ 41,266  | \$ 230,662 |
| Income taxes paid          | \$ 398,880 | \$ 25,557  |

Non-cash investing and financing activities:

|  |            |    |
|--|------------|----|
| Reclassification of deposits from other assets to property and equipment upon purchase of property and equipment | \$ 378,455 | \$ |
| Purchase of investments on margin  | 1,693,084  |    |
| Net unrealized gain on securities available for sale, net deferred income tax of \$421,354                       | \$ 735,575 | \$ |

See accompanying notes to consolidated financial statements.

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**WESTERN SIZZLIN CORPORATION**

Notes to Consolidated Financial Statements

Nine Months Ended September 30, 2006 and 2005

(Unaudited)

**(1) General**

The accompanying unaudited consolidated financial statements of Western Sizzlin Corporation, (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all material reclassifications and adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the results of operations, financial position and cash flows for each period shown have been included. The unaudited consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. For further information, refer to the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2005.

**(2) Reverse Stock Split and Rights Offering**

On July 31, 2006, the Board of Directors approved a 1-for-10 reverse stock split. The record date of the transaction was August 10, 2006. No fractional shares were issued in connection with the reverse stock split. The par value of the common stock remained at \$0.01 per share after the reverse stock split. Unless otherwise indicated, the capital stock accounts and all share and earnings per share data in this report give effect to the reverse stock split, applied retroactively to all periods presented.

The SEC declared the Company's Form S-3 Registration Statement (as amended) effective as of November 7, 2006. The Company has set a record date for the offering of November 9, 2006 and an expiration date of December 8, 2006. The Company will distribute at no charge to stockholders one transferable right for each share of common stock held on the recorded date. For every two rights held, a stockholder will be entitled to purchase one share of the Company's common stock for \$7.00. The net cash proceeds from the sale of the common stock offered, after payment of fees and expenses, are anticipated to be approximately \$4 million. Net proceeds are expected to be used for general corporate purposes, working capital, to make acquisitions of, or investments in, related or unrelated lines of business, as described in the offering prospectus.

**(3) Stock Options**

The Company has three stock option plans: the 2005 Stock Option Plan, the 2004 Non-Employee Directors' Stock Option Plan, and the 1994 Incentive and Non-qualified Stock Option Plan. Options are no longer granted under the 1994 Plan and only 7,500 options granted to James C. Verney remain outstanding under that plan. Under the 2005 and 2004 Plans, employees and directors may be granted options to purchase shares of common stock at the fair market value on the date of the grant. During the nine months ended September 30, 2006, under the provisions of the plans, the contract terms of stock options for resigning directors were reduced and have been reflected in the computations of the weighted average contractual term of the outstanding options. Since this modification did not increase the value of the awards, the modification had no impact on compensation expense.

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Effective January 1, 2006, the Company began recording compensation expense associated with the stock options in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 123R, Share-Based Payment as interpreted by SEC Staff Accounting Bulletin No. 107. Previously the Company had accounted for stock options according to the provisions of Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, and as allowed by SFAS No. 123, Accounting for Stock-Based Compensation, therefore, no related compensation expense was recorded for awards granted with no intrinsic value. The Company adopted the modified prospective transition method provided for under SFAS No. 123R, and consequently has not retroactively adjusted results from prior periods.

As a result of adopting SFAS No.123R, the Company recorded \$0 and \$39,100 of compensation expense for stock options in General and Administrative expenses for the three and nine months ended September 30, 2006, which had the effect of reducing pre-tax earnings by \$39,100, net income by approximately \$24,000, basic earnings per share by \$0.02 and diluted earnings per share by \$0.02 for the nine months ended September 30, 2006. The adoption of 123R had no impact on the Company's cash flows.

Options granted under the 2005 and 2004 Plans vest at the date of the grant, with the exception of options granted to James C. Verney, which vested according to a schedule in his Employment Agreement and are currently all vested. The fair value of each option award was estimated on the date of grant using the Black-Scholes option-pricing model. Assumptions utilized in the model were evaluated and revised, as necessary, to reflect market conditions and experience. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatilities are based on the historical volatility of the Company's stock for a period equal to the expected term of the options. The expected term of the options represents the period of time that options granted are outstanding and is estimated using historical exercise and termination experience.

Prior to the adoption of SFAS 123R, the benefit of tax deductions in excess of recognized stock compensation expense was reported as a reduction of taxes paid within operating cash flows. SFAS 123R requires that such benefits be recognized as a financing cash flow. The benefit of tax deductions in excess of recognized stock compensation expense for the nine months ended September 30, 2006 was immaterial.

The following table illustrates the effect of net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company's option plans for the three and nine months ended September 30, 2005:

|   | <b>Three Months Ended<br/>September 30,<br/>2005</b> | <b>Nine Months Ended<br/>September 30,<br/>2005</b> |
|---|--|---|
| <b>Net Income:</b>  |  |   |
| As reported   | \$ 203,548   | \$ 378,992  |
| Deduct total stock-based employee compensation expense determined under fair value based method for all outstanding and unvested awards, net of tax | 96,432   | 130,594   |
| <b>Pro forma</b>  | <b>\$ 107,116</b>                                    | <b>\$ 248,398</b>                                   |
| <b>Basic and diluted net income per share:</b>  |  |   |
| As reported   | \$ 0.09  | \$ 0.21   |
| <b>Pro forma</b>  | <b>\$ 0.09</b>                                       | <b>\$ 0.21</b>                                      |

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The fair value of options granted during the nine months ended September 30, 2006 and 2005 was estimated on the date of grant using the Black-Scholes option pricing model based on the following weighted average assumptions in the table below:

|                         | Nine Months<br>Ended September 30, |   |       |   |
|-------------------------|------------------------------------|---|-------|---|
|                         | 2006                               |   | 2005  |   |
| Expected term (years)   | 5                                  |   | 9.1   |   |
| Risk-free interest rate | 5.08                               | % | 4.09  | % |
| Volatility              | 84.03                              | % | 53.47 | % |
| Dividend yield          |                                    |   |       |   |

There were 0 and 6,000 stock options granted during the three and nine month periods ended September 30, 2006. The estimated fair value at the date of grant was \$5.10 for the 1,000 stock options granted during the first quarter of 2006 and \$6.80 for the 5,000 stock options granted during the second quarter of 2006. There were no grants during the third quarter of 2006. The estimated weighted average fair value of the stock options granted during the nine month period ended September 30, 2006 was \$6.50. There were 46,500 stock options granted during the nine-month period ended September 30, 2005, all at an estimated fair value of \$5.77.

The following table summarizes stock options outstanding as of September 30, 2006, as well as activity during the nine-month period then ended:

|                             | Options<br>Outstanding | Exercise Price Per Share<br>Weighted<br>Average | Contractual<br>Term<br>Weighted<br>Average | Aggregate<br>Intrinsic<br>Value |
|-----------------------------|------------------------|---|--|---------------------------------|
| Balance, December 31, 2005  | 67,000                 | \$ 9.00   |  | \$ 236,400                      |
| Granted                     | 6,000                  | 9.80  |  |                                 |
| Exercised                   | (3,000)                | ) 9.20  |  | \$ 2,300                        |
| Expired                     | (9,000)                | ) 9.20  |  |                                 |
| Balance, September 30, 2006 | 61,000                 | \$ 9.10   | 4.9  | \$ 135,200                      |

All options outstanding at September 30, 2006 are exercisable. At September 30, 2006, there were 39,000 shares available for future grants under the plans. The presentation above reflects the reverse stock split effective August 10, 2006 (Note 2).

#### (4) Investment in Marketable Security

During the third quarter ended September 30, 2006, the Company purchased common stock in Friendly Ice Cream Corp. Investment and all other capital allocation decisions are made by Mr. Biglari, the Company's Chairman, under the limited authority delegated by the Board of Directors. The delegated authority includes the authority to borrow funds in connection with making investments in marketable securities, subject to Board reporting requirements and various limitations. As of the date of this filing, Mr. Biglari has authority to manage surplus cash up to \$5.5 million, and, in addition, has authority to borrow a maximum of \$2 million. The Company has a margin securities account with Jefferies & Company, Inc. The margin account bears interest at the Federal Funds Target Rate quoted by the Wall Street Journal, plus .5%, or approximately 5.75% as of the date of this report, with the minimum and maximum amount of any particular loan to be determined by Jefferies, in its discretion, from time to time. The collateral securing the margin loans are the Company's holdings in the marketable security. The minimum and maximum amount of any particular margin may be established by Jefferies, in its discretion, regardless of the amount of

collateral delivered to Jefferies, and Jefferies may change such minimum and maximum amounts from time to time. The Company's balance of margin debt was \$1,693,084 as of September 30, 2006. Subsequent to September 30, 2006, the Company borrowed \$695,000 against its line of credit with Branch Banking and Trust to repay an additional \$700,000 borrowed on margin on October 2, 2006.

The Company's investments in marketable equity securities are held for an indefinite period and thus are classified as available for sale. Available-for-sale securities are recorded at fair value in Investments in marketable security on the balance sheet, with the change in fair value during the period excluded from earnings and recorded net of tax as a component of other comprehensive income.

Following is a summary of our marketable equity security:

|                         | September 30, 2006 |              | Gross Unrealized Gains |
|-------------------------|--------------------|--------------|------------------------|
|                         | Cost               | Fair Value   |                        |
| Friendly Ice Cream Corp | \$ 3,793,084       | \$ 4,950,013 | \$ 1,156,929           |

**(5) Goodwill and Other Intangible Assets**

The Company conforms to the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are reviewed for impairment and written down and charged to results of operations when their carrying amount exceeds their estimated fair value. The Company is required to perform impairment tests each year, or between yearly tests in certain circumstances, for goodwill. There can be no assurance that future impairment tests will not result in a charge to earnings.

There were no changes in the net carrying amount of goodwill for the three and nine-months ended September 30, 2006 and 2005.

*Amortizing Intangible Assets*

Franchise royalty contracts are amortized on a straight-line basis over fifteen years, the estimated average life of the franchise agreements. The Company assesses the recoverability of this intangible asset by determining whether the amortization of the franchise royalty contracts balance over their remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds.

|                               | As of September 30, 2006<br>Gross carrying amount | Weighted average amortization period | Accumulated amortization |
|-------------------------------|---|--------------------------------------|--------------------------|
| Amortizing intangible assets: |   |                                      |                          |
| Franchise Royalty Contracts   | \$ 9,454,431                                      | 15.0 yrs.                            | \$ 8,036,266             |

Aggregate amortization expense for amortizing intangible assets for the three and nine-month periods ended September 30, 2006 was \$157,574 and \$472,722, respectively. Estimated amortization expense is \$630,300 per year through December 31, 2008.

**(6) Earnings Per Share**

Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Stock options of 0 and 6,000 shares of common stock for the three and nine-month periods ended September 30, 2006 and stock options of 32,500 and 46,500 shares of common stock for the three and nine-month periods ended September 30, 2005, respectively, were not included in computing diluted earnings because the effect of these options are anti-dilutive.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the periods indicated:

|  | Income<br>(Numerator) | Weighted<br>Average<br>Shares<br>(Denominator) | Earnings<br>Per Share<br>Amount |
|--|-----------------------|--|---------------------------------|
| <b>Three months ended September 30, 2006</b> |                       |  |                                 |
| Net income basic                             | \$ 84,651             | 1,191,133                                      | \$ .07                          |
| Net income diluted                           | \$ 84,651             | 1,197,802                                      | \$ .07                          |
| <b>Three months ended September 30, 2005</b> |                       |  |                                 |
| Net income basic                             | \$ 203,548            | 1,188,857                                      | \$ .17                          |
| Net income diluted                           | \$ 203,548            | 1,188,857                                      | \$ .17                          |
| <b>Nine months ended September 30, 2006</b>  |                       |  |                                 |
| Net income basic                             | \$ 234,055            | 1,189,656                                      | \$ .20                          |
| Net income diluted                           | \$ 234,055            | 1,198,462                                      | \$ .20                          |
| <b>Nine months ended September 30, 2005</b>  |                       |  |                                 |
| Net income basic                             | \$ 378,992            | 1,189,534                                      | \$ .32                          |
| Net income diluted                           | \$ 378,992            | 1,189,534                                      | \$ .32                          |

**(7) Closed Store Expense**

Closed store expense for the nine months ended September 30, 2006 and 2005 was \$0 and \$350,279, respectively. In the three months ended March 31, 2005, the Company recorded closed store expenses of \$350,279, which included impairments of \$128,471 associated with the end of a subleased property due to a buyout of the lease and impairments related to the closing of a Company-operated restaurant of \$221,808. There was no additional closed store expense or impairments recorded in the nine months ended September 30, 2006.

**(8) Reportable Segments**

The Company has organized segment reporting with additional information to reflect how the Company views its business activities. During the third quarter of 2006, operating segments of our Company have been identified based on separate financial information that is evaluated regularly in deciding how to allocate resources and in assessing performance. This format reflects a change from previous reports. The Company-operated Restaurant segment consists of the operations of all Company-operated restaurants and derives its revenues from restaurant operations. This segment also includes net costs incurred from subleases of previously operated locations, which is presented separately. The Franchising segment consists primarily of franchise

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sales and support activities and derives its revenues from sales of franchise and development rights and collection of royalties from franchisees. The Corporation does not allocate certain expenses to any business segment. These costs include expenses of the following functions: legal, accounting stockholder relations, personnel not directly related to a segment, information systems and other headquarter activities. These unallocated expenses are designated under Corporate. All periods presented reflects the change in segment reporting.

The following table summarizes reportable segment information:

|   | Three Months<br>Ended September 30, |              | Nine Months<br>Ended September 30, |               |
|---|-------------------------------------|--------------|------------------------------------|---------------|
|   | 2006                                | 2005         | 2006                               | 2005          |
| <b>Revenues from reportable segments:</b> |                                     |              |                                    |               |
| Restaurants                               | \$ 3,393,679                        | \$ 3,655,713 | \$ 9,971,290                       | \$ 11,629,512 |
| Franchising                               | 1,092,221                           | 1,156,042    | 3,376,985                          | 3,571,541     |
| Total revenues                            | \$ 4,485,900                        | \$ 4,811,755 | \$ 13,348,275                      | \$ 15,201,053 |
| <b>Depreciation and amortization:</b>     |                                     |              |                                    |               |
| Restaurants                               | \$ 107,377                          | \$ 81,659    | \$ 313,537                         | \$ 263,029    |
| Franchising                               | 157,574                             | 157,574      | 472,722                            | 472,722       |
| Corporate                                 | 2,887                               | 22,871       | 5,560                              | 75,327        |
| Total depreciation and amortization       | \$ 267,838                          | \$ 262,104   | \$ 791,819                         | \$ 811,078    |
| <b>Interest expense:</b>                  |                                     |              |                                    |               |
| Restaurants                               | \$ 30,057                           | \$ 63,468    | \$ 108,334                         | \$ 220,365    |
| Corporate                                 |                                     | 43           | 70                                 | 1,063         |
| Total interest expense                    | \$ 30,057                           | \$ 63,511    | \$ 108,404                         | \$ 221,428    |
| <b>Interest income:</b>                   |                                     |              |                                    |               |
| Corporate                                 | \$ 16,343                           | \$ 19,021    | \$ 53,443                          | 53,215        |
| Total interest income                     | \$ 16,343                           | \$ 19,021    | \$ 53,443                          | \$ 53,215     |
| <b>Equity in loss of joint venture:</b>   |                                     |              |                                    |               |
| Franchising                               | \$ 29,629                           | \$           | \$ 67,857                          | \$            |
| Total equity in loss of joint venture     | \$ 29,629                           | \$           | \$ 67,857                          | \$            |
| <b>Income (loss) from operations:</b>     |                                     |              |                                    |               |
| Restaurants                               | \$ 281,517                          | \$ 388,344   | \$ 747,822                         | \$ 1,071,075  |
| Subleased properties                      | (106,508 )                          | (42,566 )    | (254,667 )                         | (143,015 )    |
| Franchising                               | 671,953                             | 720,563      | 2,016,923                          | 2,230,192     |
| Corporate                                 | (647,885 )                          | (690,486 )   | (1,911,202 )                       | (2,617,787 )  |
| Gain on settlement of insurance claims    |                                     |              |                                    | 220,351       |
| Total income from operations:             | \$ 199,077                          | \$ 375,855   | \$ 598,876                         | \$ 760,816    |

|                                      | September 30,<br>2006 | December 31,<br>2005 |
|--------------------------------------|-----------------------|----------------------|
| <b>Total assets:</b>                 |                       |                      |
| Restaurants                          | \$ 2,572,131          | \$ 2,341,494         |
| Franchising                          | 2,380,179             | 2,907,946            |
| Corporate                            | 2,308,690             | 5,916,192            |
| Investments in marketable securities | 4,950,013             |                      |
| Goodwill of acquired businesses      | 4,310,200             | 4,310,200            |
| Total assets                         | \$ 16,521,213         | \$ 15,475,832        |

(9) **Contingencies**

In the case of all known contingencies, the Company accrues for an obligation, including estimated legal costs, when a loss is probable and the amount is reasonably estimable. As facts concerning contingencies become known to the Company, the Company reassesses its position with respect to accrued liabilities and other expenses. These estimates are subject to change as events evolve and as additional information becomes available during the litigation process. As of September 30, 2006, the Company has accrued \$175,000 related to the items discussed below.

**Little Rock, Arkansas Lease**

In September 2006, the Company was served with a lawsuit filed in the Circuit Court of Pulaski County, Arkansas, captioned *Parks Land Company, LLLP, et al. v. Western Sizzlin Corporation, et al.* The plaintiffs are owners/landlords of four restaurant premises located in the Little Rock, Arkansas metropolitan area which had been leased pursuant to a single lease agreement and previously occupied by the Company. Most recently, each of these premises has been subleased to various operators. The lease agreement expired pursuant to its terms on June 30, 2006. The plaintiffs have claimed in their lawsuit unspecified damages allegedly owing for certain repair and maintenance expenses on the premises, for the replacement of certain equipment, for diminution of property value, and for loss of rental income, as well as interest and costs. At this time the likelihood of an unfavorable court outcome, or any potential loss, cannot be made with certainty. However, the Company is prepared to vigorously contest the plaintiff's claims and will pursue applicable cross claims and counterclaims.

**FFCA**

In January 2001, the Company executed a series of Master Lease Agreements ( Agreements ) relating to certain franchised properties formerly operated by other parties as Quincy's restaurants ( Former Quincy's ). Signed copies of these Agreements were required, pursuant to the terms of the document, to be executed by Franchise Financing Corporation of America, now known as General Electric Franchise Finance Corporation, (the Lessor ), to be legally binding; however, no signed copies were ever returned to the Company. At the end of January 2002, there remained only 25 Former Quincy's operated by Company franchisees, the Lessor having taken back, in 2001 and 2002, other restaurants previously operated by Company franchisees. The Agreements, incomplete for a lack of signature by the Lessor, provided for rental payments from the Company to the Lessor. However, the cost of any rental payments was passed on to the franchisees operating the properties. During 2002 and 2003, nine of the remaining twenty-five properties were closed and the franchisees discontinued making payments to the Company. On May 15, 2003, the Company sent a letter to the Lessor, providing notice of the Company's termination of any tenancies at-will on any remaining Former Quincy's units effective May 31, 2003. No response has ever been received from Lessor.

Following the May 15, 2003 termination of the tenancies at-will, the Company advised five franchisees who continued to operate former Quincy's units at that time to make any rent payments directly to FFCA. With regard to eleven other former Quincy's units, the Company became aware, on or about May 15, 2003, that the franchisees had elected to make their payments directly to FFCA and it is the Company's understanding that FFCA has accepted these payments. There can be no assurances that the franchisees have made their payments and will continue to make their lease payments in the future or that they even continue to operate these restaurants. The Company's estimate of the total payments that were made directly to the lessor for these sixteen franchisees, or former franchisees, is approximately \$3,894,000 through September 30, 2006.

While the Company disputes any liability for any of the following amounts, to the Company's knowledge, as of September 30, 2006 a total of approximately \$3,063,000 of rental payments had not been made by either the franchisees or by the Company with regard to the above-referenced nine closed properties.

In accordance with the Company's position, the Company has returned to FFCA any invoice for rent expense, or tax statement, received after May 15, 2003, with a cover letter explaining that the Company is not responsible for any such amounts. The Company intends to vigorously contest any potential claims asserted by General Electric Franchise Finance Corporation. While the Company has previously engaged in discussions with the Lessor of the properties to resolve any rental payments claimed by the Lessor under the Agreements, it is not possible at this time to determine the outcome of these discussions.

#### **Dickson, Tennessee Claim**

In 1994, the Company entered into a lease agreement for a restaurant located in Dickson, Tennessee. The lease agreement has an original term of 15 years. The Company ceased operations on the premises as a restaurant in 1996 and subsequently subleased the property. The location had been vacant since September 2001. In June 2004, the Company advised the landlord that the Company was surrendering the property. The Company asserted that the landlord was obligated to attempt to find a replacement tenant.

Thereafter, the landlord filed several collection actions alleging default under the lease agreement and seeking collection of unpaid rent, real estate taxes and attorney's fees. The landlord's initial filings were resolved with the payment of rent and related obligations. Later filings were defended on the basis that the landlord had failed to mitigate any damages. Judgments granted the landlord in a total amount in excess of \$142,000 were appealed.

On April 11, 2006, the Company resolved all disputes with the landlord with the execution of a formal settlement agreement. The Company has been released from any further obligations under the lease, and all pending judgments have been satisfied, in exchange for a payment by the Company to the landlord in the amount of \$177,000, also made on April 11, 2006.

#### **Chubb Claim**

In November 2004, Chubb Insurance filed suit in the Circuit Court for the City of Roanoke against our subsidiary, seeking recovery of allegedly unpaid premiums in the amount of \$97,249. Western Sizzlin Stores has never been billed by Chubb and never had any direct contractual relations with Chubb. Payments were sent to an insurance broker handling insurance needs for Western Sizzlin Stores. Chubb's claim was settled on February 6, 2006 with a payment of \$15,000.

#### **Lawrenceville, Georgia Casualty**

On July 11, 2004, the building, improvements, and contents located on real property owned by the Company in Lawrenceville, Georgia were completely destroyed by fire. As a result of this casualty, the Company terminated the lease of the tenant operating the restaurant on these premises. Insurance proceeds of \$591,000 were received in April 2005 and a gain on the casualty of \$220,351 was recorded as gain on settlement of insurance claims during the first quarter of 2005. The land is currently for sale and the Company does not anticipate any impairment on this property based on current estimates of fair value. In accordance with the note payable agreement related to the property, the insurance proceeds were remitted to the Company's lender on April 8, 2005. Subsequently, in February 2006, the remainder of the loan balance, \$280,663, was paid off and the lender accepted the total repayment of the loan without the application of a prepayment penalty.

#### **Waldorf, Maryland Casualty**

In July 2005, a building, improvements, and contents, located upon real property leased by the Company for operation of a company-owned Great American Buffet restaurant, in Waldorf, Maryland, were totally destroyed by fire. The Company insured the premises, including buildings and contents, against casualty, such as fire. The Company also insured the premises for the interruption of business income. The fire occurred shortly after the Company had provided timely

notice to the landlord of our desire to extend the lease through a renewal term ending on December 31, 2010. Since the fire, the Company repeatedly demanded that the landlord rebuild the premises and asserted that the landlord was responsible for any cost to rebuild in excess of the available insurance proceeds.

In August 2005, the landlord filed an action for a declaratory judgment in the Circuit Court for Charles County, Maryland. On or about December 14, 2005, the Company entered into a settlement agreement with the Landlord which resolved all litigation claims regarding the parties' respective interests in the real property and insurance proceeds covering real and personal property involved in the casualty. Pursuant to this agreement the Company received insurance proceeds of approximately \$1,030,000 in the first quarter of 2006.

#### **Other**

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of the management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial condition, results of operations or liquidity.

#### **(10) Change in Estimate**

At December 31, 2005, \$83,500 had been accrued for management's estimate of losses on subleases through the end of the lease termination date of June 30, 2006. Based on a subsequent guarantee obtained on the rent and subsequent collection of past due rents, the Company reversed the accrual as of March 31, 2006 and has included the reversal as a reduction of restaurant operating expenses.

#### **(11) Early Extinguishments of Long-Term Debt**

During the first quarter of 2006, the Company paid off three loans. The payoffs included a write off of financing costs associated with the early extinguishments of long-term debt of \$29,699 and a prepayment penalty assessed on one of the loans of \$62,836.

#### **(12) Investment in Unconsolidated Joint Venture**

The Company is a partner in a 50/50 joint venture with a franchisee for a new restaurant in Harrisonburg, Virginia. During October 2005, the joint venture entered into a loan agreement for \$3.05 million and the Company has guaranteed 50% of the loan obligation. The Company estimated the fair value of the guarantee to be approximately \$30,000 and recorded the amount in other long-term liabilities and its investments in unconsolidated joint venture on the accompanying balance sheet at December 31, 2005. There was no change at September 30, 2006 based on the Company's current estimate of the fair value of the guarantee. The term of the guarantee extends through July 1, 2026 and the Company would be required to perform under the guarantee should the joint venture not be able to meet its scheduled principal and interest payments. Pursuant to the joint venture agreement, a cash contribution of \$300,000 from each 50/50 partner was also made at the closing of this financing. The Company accounts for its investment using the equity method and the Company's share of the net loss for the joint venture of \$29,629 and \$67,857 for the three and nine months ended September 30, 2006 is included in equity in loss of unconsolidated joint venture. The Company has recorded a receivable from the joint venture of \$116,693 at September 30, 2006 and the corresponding payable is reflected on the balance sheet of the joint venture. The restaurant is scheduled to open December 2006.

**Financial Data**

The following is selected financial information for the joint venture at September 30, 2006:

|  | <b>Three Months<br/>Ended<br/>September 30, 2006<br/>(unaudited)</b> | <b>Nine Months<br/>Ended<br/>September 30, 2006<br/>(unaudited)</b> |
|--|--|---|
| <b>Statement of Operations Data:</b>                       |  |   |
| Total revenues   | \$   | \$  |
| Payroll expense  | 31,480   | 46,940  |
| Prototype plan expense                                     | 238  | 11,201  |
| Smallwares   | 5,100  | 5,100   |
| Interest   | 13,823   | 32,570  |
| Net loss   | (58,735  | ) (135,714  |
| <b>Balance Sheet Data:</b>                                 |  |   |
| Cash   |  | 24,916  |
| Land, leasehold improvements, and construction in progress |  | 2,007,689   |
| Loan costs, net  |  | 13,852  |
| Total assets   |  | 2,047,088   |
| Loan payable   |  | 1,396,473   |
| Accounts payable and accrued expenses                      |  | 20,729  |
| Members' equity  |  | 421,050   |

**(13) Impact of Recently Issued Accounting Standards**

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (an Interpretation of FASB Statement No. 109) (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FAS 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirements of FIN 48 are effective for our fiscal year beginning January 1, 2007. We are in the process of evaluating this guidance and therefore have not yet determined the impact that FIN 48 will have on our financial statements upon adoption.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. We have not yet determined the impact, if any, that the implementation of SFAS No. 157 will have on our results of operations or financial condition.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). SAB No. 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material and therefore must be quantified. SAB No. 108 is effective for fiscal years ending on or after

November 15, 2006. We have not yet determined the effect, if any, that the application of SAB No. 108 will have on our results of operations or financial condition.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Overview**

The following discussion may include forward-looking statements including anticipated financial performance, business prospects, the future opening of Company-operated and franchised restaurants, anticipated capital expenditures, and other matters. All statements other than statements of historical fact are forward-looking statements. Section 27A of the Securities Act of 1933 (as amended) and Section 21E of the Securities Exchange Act of 1934 (as amended) provide safe harbors for forward-looking statements. In order to comply with the terms of these safe harbors, the Company notes that a variety of factors, individually or in the aggregate, could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements including, without limitation, the following: the ability of the Company or its franchisees to obtain suitable locations for restaurant development; consumer spending trends and habits; competition in the restaurant segment with respect to price, service, location, food quality and personnel resources; weather conditions in the Company's operating regions; laws and government regulations; general business and economic conditions; availability of capital; success of operating initiatives and marketing and promotional efforts; and changes in accounting policies. In addition, the Company disclaims any intent or obligation to update those forward-looking statements.

The Company operated and franchised a total of 129 restaurants located in 19 states, including 5 Company-owned and 124 franchise restaurants as of September 30, 2006. The restaurants include a family steakhouse concept and a steak and buffet concept.

The Company's objective is to maximize its intrinsic business value per share over the long term. In meeting this objective, the Company will evaluate all investment alternatives to achieve above-average returns on capital. The Company will continue to franchise restaurants and maximize operating results of the five Company-operated restaurants.

The Company seeks to invest in stocks of businesses at prices below their intrinsic business value. The Company's preferred strategy is to allocate a meaningful amount of capital in each investee, resulting in concentration. As of the date of this filing, the equity investment portfolio included one stock, Friendly Ice Cream Corporation. The carrying values of the Company's equity securities 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 the Company's stockholder's equity. (See Note 4) Operating decisions for the Company are made by management. As described above, investment and all other capital allocation decisions are made for the Company by Mr. Biglari, Chairman of the Board of Directors.

A strategic alliance with Star Buffet, Inc. was announced in April 2006. Star Buffet announced plans to convert certain of its existing restaurants to the Western Sizzlin brand and to test a newly developed Western Sizzlin buffet prototype. As of September 30, 2006, Star Buffet had not opened or converted any restaurants into a Western Sizzlin brand.

On August 10, 2006, the Company effected a 1-for-10 reverse stock split pursuant to the discretionary authority granted by the stockholders at the Annual Meeting of Stockholders on June 20, 2006.

The SEC declared the Company's Form S-3 Registration Statement (as amended) effective as of November 7, 2006. The Company has set a record date of November 9, 2006 and an expiration date of December 8, 2006.

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**Results of Operations**

Net income for the three and nine months ended September 30, 2006 was \$84,651 and \$234,055 compared to net income of \$203,548 and \$378,992 for the three and nine months ended September 30, 2005.

The following table sets forth for the periods presented the percentage relationship to total revenues of certain items included in the consolidated statements of income and certain restaurant data for the periods presented:

|   | Three Months             |        | Nine Months              |        |
|---|--------------------------|--------|--------------------------|--------|
|   | Ended September 30, 2006 | 2005   | Ended September 30, 2006 | 2005   |
| <b>Revenues:</b>  |                          |        |                          |        |
| Company-operated restaurants                                | 75.7 %                   | 76.0 % | 74.8 %                   | 76.5 % |
| Franchise royalties and fees                                | 24.3                     | 24.0   | 25.2                     | 23.5   |
| Total revenues  | 100.0                    | 100.0  | 100.0                    | 100.0  |
| <b>Costs and Expenses:</b>                                  |                          |        |                          |        |
| Company-operated restaurants food, beverage and labor costs | 52.7                     | 52.7   | 53.2                     | 54.4   |
| Restaurant occupancy and other                              | 15.7                     | 13.5   | 14.1                     | 13.3   |
| Subleased restaurant expenses                               | 2.4                      | .9     | 1.9                      | 1.2    |
| Franchise operations direct support                         | 5.9                      | 5.8    | 6.6                      | 5.7    |
| Corporate expenses  | 12.9                     | 13.9   | 13.8                     | 14.2   |
| Depreciation and amortization                               | 6.0                      | 5.4    | 5.9                      | 5.3    |
| Closed store expenses                                       |                          |        |                          | 2.3    |
| Gain on settlement of insurance claims                      |                          |        |                          | (1.4 ) |
| Total costs and expenses                                    | 95.6                     | 92.2   | 95.5                     | 95.0   |
| Income from operations                                      | 4.4                      | 7.8    | 4.5                      | 5.0    |
| Other income (expense)                                      | (1.1 )                   | (1.0 ) | (1.5 )                   | (.9 )  |
| Income before income tax expense                            | 3.3                      | 6.8    | 3.0                      | 4.1    |
| Income tax expense  | 1.4                      | 2.6    | 1.2                      | 1.6    |
| Net income  | 1.9 %                    | 4.2 %  | 1.8 %                    | 2.5 %  |

|   | Three Months            |      | Nine Months             |      |
|---|-------------------------|------|-------------------------|------|
|   | Ended September 30 2006 | 2005 | Ended September 30 2006 | 2005 |
| <b>Restaurant Data</b>                  |                         |      |                         |      |
| Number of Company-Operated Restaurants: |                         |      |                         |      |
| Beginning of period                     | 5                       | 6    | 5                       | 6    |
| Opened                                  |                         |      |                         |      |
| Closed                                  |                         | 1    |                         | 1    |
| Franchised                              |                         |      |                         |      |
| End of period                           | 5                       | 5    | 5                       | 5    |
| Number of U.S. Franchised Restaurants:  |                         |      |                         |      |
| Beginning of period                     | 130                     | 144  | 135                     | 148  |
| Opened                                  |                         | 1    |                         | 3    |
| Closed                                  | 6                       | 5    | 11                      | 11   |
| End of period                           | 124                     | 140  | 124                     | 140  |

## Revenues

Company-operated restaurant revenues decreased \$262,000 (7.2%) to \$3.4 million for the three months ended September 30, 2006 as compared to \$3.7 million for the comparable three months ended September 30, 2005. Revenues for Company-operated restaurants decreased \$1.7 million (14.3%) to \$10.0 million for the nine months ended September 30, 2006 as compared to \$11.6 million for the comparable nine months ended September 30, 2005. The decreases are largely attributable to the closing of a Company-operated location in February, 2005 and a closing of a Company-operated location in July, 2005 due to a total loss by fire casualty. Same store sales for the three and nine months ended September 30, 2006, experienced an overall decrease of 0.86% and 0.06%, respectively.

Franchise revenues decreased 5.5% to \$1.1 million for the three months ended September 30, 2006 as compared to \$1.2 million for the comparable three months ended September 30, 2005. Franchise revenues decreased 5.4% to \$3.4 million for the nine months ended September 30, 2006

as compared to \$3.6 million for the nine months ended September 30, 2005. The decreases are attributable to fewer franchised units in the system at September 30, 2006 as compared to September 30, 2005. Same store sales for the three and nine months ended September 30, 2006, experienced an overall increase of 2.63% and 1.65%, respectively.

## Costs and Expenses

Cost of Company-operated restaurants, consisting primarily of food, beverage, and labor costs decreased \$170,600 (6.7%) to \$2.4 million for the three months ended September 30, 2006 from \$2.5 million for the three months ended September 30, 2005. These costs for the three month periods stayed the same as a percentage of Company-operated restaurants revenue of 70.0% in 2005 and 2006. For the nine month period ended September 30, 2006, the costs of Company-operated restaurants decreased \$1.2 million (14.2%) to \$7.1 million from \$8.3 million in 2005. These costs for the nine month periods slightly increased as a percentage of Company-operated restaurants revenue from 71.1% in 2005 to 71.2% in 2006. The decrease in the costs was largely attributable to the closing of a Company-operated location in February 2005 and the closing due to fire of a Company-operated location in July, 2005.

Restaurant occupancy and other, which include utilities, insurance, maintenance, rent and other such costs of the Company-operated restaurants, increased by \$55,700 (8.6%) for the three months ended September 30, 2006 versus the prior year's comparable period. These costs for the three month periods increased slightly as a percentage of Company-operated restaurant revenues from 17.8% in 2005 to 20.8% in 2006. The increases for the three months ended September 30, 2006 were attributable to increased occupancy and other expenses in the restaurants. For the nine months ended September 30, 2006, restaurant occupancy and other, decreased by \$148,000 (7.3%) versus the prior year's comparable period. The decrease was attributable to the closings of two Company-operated locations in 2005. These costs for the nine months period increased as a percentage of Company-operated restaurant revenues at 18.8% in 2006 and 17.4% in 2005.

Subleased restaurant expenses includes net costs associated with subleasing former Company operations and maintenance of vacant premises. These expenses increased by \$66,000 (165.6%) for the three months ended September 30, 2006 versus the prior year's comparable period. For the nine months ended September 30, 2006, these expenses increased by \$78,000 (44.8%) versus the prior year's comparable period. The increases were largely attributable to additional expenses incurred on repair and maintenance of the facilities and uncollectible rents.

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Cost of franchise operations direct support expense were \$262,700 for the three months ended September 30, 2006 compared to \$277,900 in 2005, and were 24.1% and 24.0% as a percentage of franchise operations revenues for 2006 and 2005, respectively. Cost of franchise operations were \$887,000 and \$869,000 for the nine month periods ended September 30, 2006 and 2005, and were 26.3% and 24.3% as a percentage of franchise operations revenues, respectively. These costs are comparable year to year for the periods presented.

Unallocated corporate expenses consist of certain expenses not allocated to any business segment. These expenses include legal, accounting, stockholder relations, personnel not directly related to a segment, information systems, and other headquarter s activities. These expenses decreased by \$91,000 (13.6%) for the three months ended September 30, 2006 versus the prior year s comparable period. For the nine months ended September 30, 2006, these expenses decreased by \$319,000 (14.7%) versus the prior year s comparable period. The decreases were attributable to personnel reductions and targeted expense reductions in 2006.

Depreciation and amortization expense was \$5,700 (2.2%) more for the three months ended September 30, 2006 versus the three months ended September 30, 2005 and \$19,300 (2.4%) less for the comparable nine month period then ended. The increases in the third quarter were attributable to an increase in capital expenditures placed in service due to remodels of two Company-operated locations during 2006.

Closed store expenses were \$0 and \$350,000 for the three and nine months ended September 30, 2005 and there was no closed store expense in 2006 for the comparable periods. The first quarter 2005 expenses included impairment of \$128,000 associated with the end of a subleased property due to a buyout of the lease and impairments related to the closing of a Company-operated restaurant of \$222,000 in February 2005.

### **Other Income (Expense)**

Interest expense decreased \$33,500 and \$113,000 for the three and nine months ended September 30, 2006 over the comparable periods in 2005 due to a lower average principal outstanding balance. Interest income fluctuates according to the levels of available cash balances. The Company employs a cash management system whereby available balances are invested on an overnight basis.

Other expense increased \$3,000 for the three months ended September 30, 2006 and increased \$57,000 for the nine months ended September 30, 2006 over the comparable periods in 2005. The increases were largely attributable to the recording of the equity in loss of joint venture during 2006.

Income tax expense is directly affected by the levels of pretax income. The Company s effective tax rate was 43.3% and 38.1% for the three and nine months ended September 30, 2006 and 41.0% and 38.4% for the same periods in 2005. The increased percentages were largely attributable to deferred income tax effect of unrealized holding gains on the investment in a marketable security.

### **Cash and Cash Equivalents**

As of September 30, 2006, the Company had \$124,361 of cash and cash equivalents as compared to \$1.9 million as of September 30, 2005. The decline in cash and cash equivalents was largely attributable to a purchase of an investment in a marketable security of \$2.1 million, payments of long-term debt of \$1.4 million, partially offset by proceeds from fire casualty and cash generated from operations of \$1.4 million.

### **Investment of Available Capital**

The Company s cash flows have exceeded its working capital, financing and capital investment needs, and management expects that the Company s cash flows will continue to exceed its operating cash needs for the foreseeable future. The Company regularly evaluates how best to use

available capital to increase stockholder value. The Company may pursue investments in the form of acquisitions, joint ventures and partnerships where the Company believes attractive returns can be obtained. Further, the Company may determine under certain market conditions that available capital is best utilized to fund investments that it believes offer the Company attractive return opportunities, whether or not related to its ongoing business activities.

As previously disclosed in Note 4, the Company's Board of Directors has delegated authority to direct investment of the Company's surplus cash to its Chairman, Sardar Biglari, subject to Board reporting requirements and various limitations that have been or may be from time to time adopted by the Board of Directors. These investments may include significant and highly concentrated direct investments with respect to the equity securities of public companies. Any such investments will involve risks, and stockholders should recognize that the Company's balance sheet may change depending on the performance of investments. Furthermore, such investments could be subject to volatility that may affect both the recorded value of the investments as well as the Company's periodic earnings. See Risk Factors, page 25.

### **Operating Activities and Cash Flows**

The Company generated approximately \$1.4 million in operating cash flows for the nine months ended September 30, 2006 and \$209,000 for the nine months ended September 30, 2005. The Company's primary source of operating cash flows is the operating profits generated from Company operations and franchise operations.

### **Investing Activities**

During the nine months ended September 30, 2006, the Company spent \$480,000 on capital expenditures compared to \$181,000 spent during the equivalent period in the prior year. Capital expenditures for 2006 included approximately \$450,000 for the remodel of two Company-operated stores in Northern Virginia. The balance of the capital expenditures was for necessary replacement of equipment and leasehold improvements in the other three Company-operated locations. Also included in investing activities for 2006 is a \$2.1 million investment in marketable security. Offsetting uses of cash for investing activities were proceeds from fire casualties of \$785,000 and \$653,000 for the nine months ended September 30, 2006 and 2005, respectively.

### **Financing Activities**

The Company made payments of long-term debt of \$1.4 million and \$1.1 million for the nine months ended September 30, 2006 and 2005, respectively.

### **Liquidity**

The Company's primary sources of liquidity are cash generated from operations and, if needed, borrowings under its existing line of debt. The Company continually reviews available financing alternatives. In addition, the Company may consider, on an opportunistic basis, strategic decisions to create value and improve operational performance.

## CRITICAL ACCOUNTING POLICIES

The discussion and analysis of financial condition and results of operations is based on the consolidated financial statements and accompanying notes that have been prepared in accordance with United States generally accepted accounting principles. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Application of the critical accounting policies discussed below requires significant judgments by management, often as a result of the need to make estimates of matters that are inherently uncertain. If actual results were to differ materially from the estimates made, the reported results could be materially affected. The Company is not currently aware of any reasonably likely events or circumstance that would result in materially different results. Senior management has reviewed the critical accounting policies and estimates and the Management's Discussion and Analysis regarding them with the Audit Committee of the Board of Directors.

### *Trade Accounts and Notes Receivable and the Allowance for Doubtful Accounts*

The Company collects royalties, and in some cases rent, from franchisees. The Company views trade accounts and notes receivable and the related allowance for doubtful accounts as a critical accounting estimate since the allowance for doubtful accounts is based on judgments and estimates concerning the likelihood that individual franchisees will pay the amounts included as receivables from them. In determining the amount of allowance for doubtful accounts to be recorded for individual franchisees, the Company considers the age of the receivable, the financial stability of the franchisee, discussions that may have occurred with the franchisee and a judgment as to the overall collectibility of the receivable from the franchisee. In addition, the Company establishes an allowance for all other receivables for which no specific allowances are deemed necessary. If average sales or the financial health of franchisees were to deteriorate, the Company might have to increase the allowance for doubtful accounts.

### *Investments*

The Company classifies our marketable securities as available-for-sale, which are reported at fair value. Unrealized holding gains and losses, net of the related income tax effect, on available-for-sale securities are excluded from income and are reported as other comprehensive income in stockholders' equity. Realized gains and losses from securities classified as available-for-sale are included in income and are determined using the specific identification method for ascertaining the cost of securities sold. All investments are marked-to-market based on quoted market prices and recorded at their fair value.

### *Long-lived Assets, Franchise Royalty Contracts and Goodwill*

The Company views the determination of the carrying value of long-lived assets, franchise royalty contracts and goodwill as critical accounting estimates since it must evaluate the estimated economic useful life in order to properly depreciate or amortize our long-lived assets and franchise royalty contracts and because it must consider if the value of any of our long-lived assets have been impaired, requiring adjustments to the carrying value. Goodwill is not subject to amortization but is subject to at least an annual impairment test to determine if the carrying amount exceeds its fair value.

Economic useful life is the duration of time the asset is expected to be productively employed, which may be less than its physical life. The estimated economic useful life of an asset is monitored to determine if it continues to be appropriate in light of changes in business circumstances.

*Commitments and Contingencies*

The Company views accounting for contingencies as a critical accounting estimate since loss contingencies arising from claims, assessments, litigation, fines and penalties and other sources require judgment as to any probable liabilities incurred. Actual results could differ from the expected results determined based on such estimates.

**OTHER**

**Impact of Inflation**

The impact of inflation on the costs of food and beverage products, labor and real estate can affect the Company's operations. Management believes the Company has historically been able to pass on increased costs through certain selected menu price increases and has offset increased costs by increased productivity and purchasing efficiencies, but there can be no assurance that the Company will be able to do so in the future. Management anticipates that the average cost of restaurant real estate leases and construction cost could increase in the future which could affect the Company's ability to expand. In addition, mandated health care or additional increases in the federal or state minimum wages could significantly increase the Company's costs of doing business.

**Impact of Recently Issued Accounting Standards**

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109 ( *FIN 48* ). *FIN 48* clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FAS 109, *Accounting for Income Taxes* . *FIN 48* prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. *FIN 48* also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirements of *FIN 48* are effective for our fiscal year beginning January 1, 2007. We are in the process of evaluating this guidance and therefore have not yet determined the impact that *FIN 48* will have on our financial statements upon adoption.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( *SFAS No. 157* ). *SFAS No. 157* clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. *SFAS No. 157* is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. We have not yet determined the impact, if any, that the implementation of *SFAS No. 157* will have on our results of operations or financial condition.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( *SAB No. 108* ). *SAB No. 108* provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material and therefore must be quantified. *SAB No. 108* is effective for fiscal years ending on or after November 15, 2006. We have not yet determined the effect, if any, that the application of *SAB No. 108* will have on our results of operations or financial condition.

**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

The Company does not engage in derivative financial instruments or derivative commodity instruments. As of September 30, 2006, the Company's financial instruments were not exposed to significant market risk due to foreign currency exchange risk. The Company is exposed to market risk related to interest rates, as well as increased prices in restaurant industry commodities such as beef.

The table below provides information about the Company's debt obligations that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted average interest rates by expected maturity dates.

Debt obligations held for other than trading purposes at September 30, 2006 (dollars in thousands):

**EXPECTED MATURITY DATE**

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|                       | 2006  | 2007   | 2008    | 2009    | 2010    | Thereafter | Total   | Estimated Fair Value |
|-----------------------|-------|--------|---------|---------|---------|------------|---------|----------------------|
| Long-term debt        |       |        |         |         |         |            |         |                      |
| Fixed Rate            | \$ 89 | \$ 163 | \$ 119  | \$ 109  | \$ 121  | \$ 336     | \$ 937  | \$ 1,011             |
| Average Interest Rate | 9.88  | % 9.96 | % 10.03 | % 10.07 | % 10.07 | % 10.07    | % 10.00 | %                    |

**Item 4. Controls and Procedures**

Our senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2006. Based on their evaluation as of December 31, 2005, they had concluded that the disclosure controls and procedures were ineffective in providing reasonable assurance that the information required to be disclosed by us in our annual report on Form 10-K was summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and Form 10-K. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of December 31, 2005, management identified a material weakness due to limited financial and accounting personnel with the appropriate expertise to ensure that our annual and periodic financial statements comply with generally accepted accounting principles ( GAAP ) and SEC reporting requirements.

The ineffective control over the application of GAAP and SEC reporting requirements related to the financial reporting process could result in a material misstatement to our annual or interim financial statements that may not be prevented or detected. Management is addressing this weakness by having formed a consulting relationship with an accounting firm other than our independent registered public accounting firm with appropriate expertise in these matters. We are using this firm to assist with the preparation and review of our filings beginning with the second quarter of 2006. There were no other changes in our internal controls or in other factors that could significantly affect these controls since the evaluation process was completed as of September 30, 2006.

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

In addition to those proceedings discussed in the Company's consolidated financial statements included in Item 1, Part 1, the Company is involved in various other claims and legal actions which are routine litigation matters incidental to the business. In the opinion of the management, the ultimate disposition of these other matters will not have a material adverse effect on the Company's financial condition, results of operations or liquidity.

Item 1A. Risk Factors

An investment in the common stock of any company involves a degree of risk. Investors should consider carefully the risks and uncertainties described in our Registration Statement on Form S-3 (as amended), on file with the SEC and incorporated herein by reference (Exhibit 99.0), which update and are in addition to those detailed in the Company's Annual Report on Form 10-K, and those other risks described elsewhere in this report, before deciding whether to purchase our common stock. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm the Company's business, financial condition, and results of operations. The occurrence of risk factors could harm the Company's business, financial condition, and results of operations for company operations, as well as franchised operations. The trading price of the Company's common stock could decline due to any of these risks and uncertainties, and stockholders may lose part or all of their investment.

Item 6. Exhibits :

See Exhibit Index on page 27.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**Western Sizzlin Corporation**

By: */s/ James C. Verney*  
James C. Verney  
President and Chief Executive Officer

By: */s/ Robyn B. Mabe*  
Robyn B. Mabe  
Vice President and Chief Financial Officer

Date: November 9, 2006

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**EXHIBIT INDEX**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.
- 99.0 Risk Factors (incorporated by reference to pages 5-12 of the Company's Registration Statement on Form S-3 (as amended)).

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