

WESTERN SIZZLIN CORP  
Form 10-Q  
August 14, 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 June 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 \_\_\_\_\_

Commission file number 0-25366

**Western Sizzlin Corporation**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**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

Edgar Filing: WESTERN SIZZLIN CORP - Form 10-Q

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 August 11, 2006, there were 1,189,850 shares of common stock outstanding.

---

Western Sizzlin Corporation

Form 10-Q  
Six Months Ended June 30, 2006  
Table of Contents

	Page
<b>PART I. FINANCIAL INFORMATION</b>	
<b><u>Item 1.</u></b>	<b><u>Financial Statements (Unaudited)</u></b>
	2
	3
	4
	5
	6-14
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>
	14-21
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosure about Market Risk</u></b>
	21
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>
	21
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>
	22
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>
	22
<b><u>Item 4.</u></b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b>
	22-23
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>
	23
<b><u>Signatures</u></b>	24
<b><u>Exhibit Index</u></b>	25

---

**PART I. FINANCIAL INFORMATION****WESTERN SIZZLIN CORPORATION****Consolidated Balance Sheets**

June 30, 2006 and December 31, 2005

	<b>June 30, 2006 (unaudited)</b>	<b>December 31, 2005</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,030,687	\$ 1,664,848
Short-term investments		260,069
Trade accounts receivable, less allowance for doubtful accounts of \$482,675 in 2006 and \$454,458 in 2005	824,931	910,776
Current installments of notes receivable	196,653	212,187
Income tax receivable	24,233	17,923
Insurance receivables		1,029,954
Other receivables	43,437	128,375
Inventories	100,374	83,506
Prepaid expenses	278,944	292,721
Deferred income taxes	138,316	226,736
Total current assets	3,637,575	4,827,095
Notes receivable, less allowance for doubtful accounts of \$140,909 in 2006 and \$119,126 in 2005, excluding current installments	880,854	876,426
Property and equipment, net of accumulated depreciation of \$3,668,298 in 2006 and \$3,690,965 in 2005	2,316,852	1,887,450
Franchise royalty contracts, net of accumulated amortization of \$7,878,693 in 2006 and \$7,563,545 in 2005	1,575,739	1,890,887
Goodwill	4,310,200	4,310,200
Financing costs, net of accumulated amortization of \$167,066 in 2006 and \$136,446 in 2005	23,238	63,764
Investment in unconsolidated joint venture	270,154	308,382
Other receivables	64,484	
Deferred income taxes	566,918	576,467
Asset held for sale	300,000	300,000
Other assets	137,351	435,161
	\$ 14,083,365	\$ 15,475,832
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Current installments of long-term debt	\$ 255,410	\$ 1,487,964
Accounts payable	507,974	523,939
Accrued expenses and other	537,338	814,005
Total current liabilities	1,300,722	2,825,908
Long-term debt, excluding current installments	768,660	848,319
Other long-term liabilities	56,761	42,087
Commitments and contingencies (Note 7)		
Stockholders equity:		
Common stock, \$.01 par value. Authorized 2,000,000 shares; 1,189,850 issued and outstanding shares in 2006 and 1,188,850 in 2005 (Note 2)	11,899	11,889
Additional paid-in capital	8,730,065	8,681,775
Retained earnings	3,215,258	3,065,854
Total stockholders equity	11,957,222	11,759,518
	\$ 14,083,365	\$ 15,475,832

See accompanying notes to consolidated financial statements.



## WESTERN SIZZLIN CORPORATION

## Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30, 2006	2005	Six Months Ended June 30, 2006	2005
<b>Revenues:</b>				
Company-operated restaurants	\$ 3,579,938	\$ 4,224,188	\$ 6,577,611	\$ 7,973,799
Franchise operations	1,040,372	1,104,122	2,093,672	2,185,944
Other	96,415	116,948	191,092	229,555
<b>Total revenues</b>	<b>4,716,725</b>	<b>5,445,258</b>	<b>8,862,375</b>	<b>10,389,298</b>
<b>Costs and expenses:</b>				
Cost of company-operated restaurants	2,292,610	2,778,266	4,409,119	5,329,889
Cost of franchise operations	521,662	429,464	970,630	924,343
Other cost of operations	87,852	76,936	171,522	165,410
Restaurant operating expenses	732,738	837,288	1,391,172	1,743,429
General and administrative	539,454	636,095	996,152	1,162,364
Depreciation and amortization	263,940	270,705	523,981	548,974
Closed store expenses				350,279
Gain on settlement of insurance claims				(220,351 )
<b>Total costs and expenses</b>	<b>4,438,256</b>	<b>5,028,754</b>	<b>8,462,576</b>	<b>10,004,337</b>
<b>Income from operations</b>	<b>278,469</b>	<b>416,504</b>	<b>399,799</b>	<b>384,961</b>
<b>Other income (expense):</b>				
Interest expense	(32,255 )	(68,921 )	(78,347 )	(157,917 )
Loss on early extinguishment of long term debt			(92,535 )	
Interest income	16,534	18,397	37,100	34,194
Equity in loss of joint venture	(34,194 )		(38,228 )	
Other	5,682	23,792	19,584	25,442
	(44,233 )	(26,732 )	(152,426 )	(98,281 )
<b>Income before income tax expense</b>	<b>234,236</b>	<b>389,772</b>	<b>247,373</b>	<b>286,680</b>
<b>Income tax expense:</b>				
Current		10,200		26,095
Deferred	91,130	137,547	97,969	85,141
<b>Total income tax expense</b>	<b>91,130</b>	<b>147,747</b>	<b>97,969</b>	<b>111,236</b>
<b>Net Income</b>	<b>\$ 143,106</b>	<b>\$ 242,025</b>	<b>\$ 149,404</b>	<b>\$ 175,444</b>
<b>Earnings per share (Note 2):</b>				
Basic	\$ .12	\$ .20	\$ .13	\$ .15
Diluted	\$ .12	\$ .20	\$ .12	\$ .15

See accompanying notes to consolidated financial statements.

## WESTERN SIZZLIN CORPORATION

## Consolidated Statement of Changes in Stockholders' Equity

Six Months Ended June 30, 2006

(Unaudited)

	Common Stock Shares	Dollars	Additional Paid-in Capital	Retained Earnings	Total
Balances, December 31, 2005	1,188,850	\$ 11,889	\$ 8,681,775	\$ 3,065,854	\$ 11,759,518
Net income				149,404	149,404
Compensation expense associated with stock options plans			39,100		39,100
Stock options exercised	1,000	10	9,190		9,200
Balances, June 30, 2006	1,189,850	\$ 11,899	\$ 8,730,065	\$ 3,215,258	\$ 11,957,222

See accompanying notes to consolidated financial statements.

## WESTERN SIZZLIN CORPORATION

## Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 149,404	\$ 175,444
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	208,832	224,741
Amortization of franchise royalty contracts	315,148	315,149
Write off of financing costs related to early extinguishment of long term debt	29,699	
Amortization of financing costs	10,827	9,086
Loss on sale/disposal of property and equipment	57,717	359,776
Gain from fire casualty		(220,351 )
Common stock related to termination of Franchise Agreement		(15,000 )
Provision for doubtful accounts	50,000	50,320
Share based compensation	39,100	
Equity in loss of unconsolidated joint venture	38,228	
Provision for deferred income taxes	97,969	85,141
(Increase) decrease in:		
Trade accounts receivable and notes receivable	46,951	6,965
Income tax receivable	(6,310 )	
Insurance receivable - business interruption	244,961	
Other receivables	20,454	48,126
Inventories	(16,868 )	47,460
Prepaid expenses	13,777	(42,560 )
Other assets	(22,526 )	(267,327 )
Increase (decrease) in:		
Accounts payable	(15,965 )	181,071
Accrued expenses	(276,667 )	(503,093 )
Other long-term liabilities	14,674	(14,841 )
Net cash provided by operating activities	999,405	440,107
Cash flows from investing activities:		
Short term investments	260,069	(2,338 )
Additions to property and equipment	(378,415 )	(85,820 )
Proceeds from sale of property	2,800	8,000
Proceeds from fire casualty	784,993	652,964
Net cash provided by investing activities	669,447	572,806
Cash flows from financing activities:		
Payments on long-term debt	(1,312,213 )	(923,403 )
Cash received from exercise of stock options	9,200	
Net cash used in financing activities	(1,303,013 )	(923,403 )
Net increase in cash and cash equivalents	365,839	89,510
Cash and cash equivalents at beginning of period	1,664,848	2,105,751
Cash and cash equivalents at end of period	\$ 2,030,687	\$ 2,195,261
Supplemental disclosure of cash flow information:		
Cash payments for interest and prepayment penalties	\$ 141,337	\$ 165,939
Income taxes paid	\$ 16,341	\$ 25,225
Non-cash investing activities:		
Reclassification of deposits from other assets to property and equipment	\$ 320,336	\$

See accompanying notes to consolidated financial statements.





**WESTERN SIZZLIN CORPORATION**

**Notes to Consolidated Financial Statements**

**Six Months Ended June 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**

On July 31, 2006, the Board of Directors approved a 1-for-10 reverse stock split ratio. The record date of the transaction is August 10, 2006. No fractional shares will be issued in connection with the reverse stock split. The par value of the Common Stock will remain 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.

**(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 six months ended June 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.

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 \$34,000 and \$39,100 of compensation expense for stock options in General and Administrative expenses for the three and six months ended June 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

## Edgar Filing: WESTERN SIZZLIN CORP - Form 10-Q

share by \$0.02 for the six months ended June 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. 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 six months ended June 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 six months ended June 30, 2005:

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
<b>Net Income:</b>		
As reported	\$ 242,025	\$ 175,444
Deduct total stock-based employee compensation expense determined under fair value based method for all outstanding and unvested awards, net of tax	24,552	24,552
<b>Pro forma</b>	<b>\$ 217,473</b>	<b>\$ 150,892</b>
<b>Basic and diluted net income per share:</b>		
As reported	\$ 0.20	\$ 0.15
<b>Pro forma</b>	<b>\$ 0.18</b>	<b>\$ 0.13</b>

The fair value of options granted during the six months ended June 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:

	<b>Six Months Ended June 30, 2006      2005</b>	
Expected term (years)	5	5
Risk-free interest rate	5.08 %	3.72 %
Volatility	84.03 %	53.60 %
Dividend yield		

There were 5,000 and 6,000 stock options granted during the three and six month periods ended June 30, 2006, which had an estimated fair value at the date of grant of \$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 three months ended June 30, 2006. The estimated weighted average fair value of the stock options granted during the six-month period ended June 30, 2006 was \$6.50. There were 9,000 stock options granted during the six-month period ended June 30, 2005, all at an estimated fair value of \$4.40.

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

	Options Outstanding	Exercise Price Per Share Weighted Average	Contractual Term Weighted Average	Aggregate Intrinsic Value
Balance, December 31, 2005	67,000	\$ 9.00		
Granted	6,000	9.80		
Exercised	(1,000 )	9.20		\$ 0
Expired	(7,000 )	9.20		
Balance, June 30, 2006	65,000	\$ 9.00	4.9	\$ 114,500

All options outstanding at June 30, 2006 are exercisable. At June 30, 2006, there were 27,000 shares available for future grants under the plan. The presentation above reflects the reverse stock split effective August 10, 2006 (Note 2).

#### (4) 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 six-months ended June 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.

	Gross carrying amount	As of June 30, 2006 Weighted average amortization period	Accumulated amortization
Amortizing intangible assets:			
Franchise Royalty Contracts	\$ 9,454,431	15.0 yrs.	\$ 7,878,693

Aggregate amortization expense for amortizing intangible assets for the three and six-month periods ended June 30, 2006 was \$157,574 and \$315,148, respectively. Estimated amortization expense is \$630,300 per year through December 31, 2008.

#### (5) 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 for 1,000 shares of common stock for the three and six month periods ended June 30, 2006 and 26,500 and 17,500 shares for the three and six month period ended June 30, 2005 were not included in computing diluted earnings because the effect of these options are anti-dilutive. The presentation reflects the reverse stock split effective August 10, 2006 (Note 2).

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

	Income (Numerator)	Weighted Average Shares (Denominator)	Earnings Per Share Amount
<b>Three months ended June 30, 2006</b>			
Net income basic	\$ 143,106	1,188,967	\$ .12
Net income diluted	\$ 143,106	1,194,066	\$ .12
<b>Three months ended June 30, 2005</b>			
Net income basic	\$ 242,025	1,188,857	\$ .20
Net income diluted	\$ 242,025	1,189,095	\$ .20
<b>Six months ended June 30, 2006</b>			
Net income basic	\$ 149,404	1,188,967	\$ .13
Net income diluted	\$ 149,404	1,197,841	\$ .12
<b>Six months ended June 30, 2005</b>			
Net income basic	\$ 175,444	1,189,857	\$ .15
Net income diluted	\$ 175,444	1,189,976	\$ .15

#### (6) Closed Store Expense

Closed store expense for the six months ended June 30, 2005 was \$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 were no additional closed store expenses or impairments recorded in the six months ended June 30, 2006.

#### (7) Reportable Segments

The Company has defined two reportable segments: Company-operated restaurants and franchising and other. The Company-operated restaurant segment consists of the operations of all Company-operated restaurants and derives its revenues from restaurant operations. The franchising and other segment consists primarily of franchise sales and support activities and derives its revenues from sales of franchise and development rights and collection of royalties from franchisees.

Edgar Filing: WESTERN SIZZLIN CORP - Form 10-Q

Generally, the Company evaluates performance and allocates resources based on income from operations before income taxes. Capital costs are allocated to segments based upon predetermined rates or actual or estimated resource usage. Corporate and franchise support expenses of \$442,009 and \$862,272 for three and six months ended June 30, 2006 and \$445,209 and \$864,934 for the three and six months ended June 30, 2005, are allocated entirely to franchising and other and are not allocated to Company-operated restaurants. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

Reportable segments are business units that provide different products or services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies. Through June 30, 2006, all revenues for each business segment were derived from business activities conducted with customers located in the United States. No single external customer accounted for 10% or more of the Company's consolidated revenues.

The following table summarizes reportable segment information:

	Three Months Ended June 30, 2006	2005	Six Months Ended June 30, 2006	2005
<b>Revenues from reportable segments:</b>				
Restaurants	\$ 3,579,938	4,224,188	6,577,611	7,973,799
Franchising and other	1,136,787	1,221,070	2,284,764	2,415,499
<b>Total revenues</b>	<b>\$ 4,716,725</b>	<b>5,445,258</b>	<b>8,862,375</b>	<b>10,398,298</b>
<b>Depreciation and amortization:</b>				
Restaurants	\$ 96,409	99,549	187,144	205,643
Franchising and other	167,531	171,156	336,837	343,331
<b>Total depreciation and amortization</b>	<b>\$ 263,940</b>	<b>270,705</b>	<b>523,981</b>	<b>548,974</b>
<b>Interest expense:</b>				
Restaurants	\$ 32,247	68,921	78,278	156,897
Franchising and other	8		69	1,020
<b>Total interest expense</b>	<b>\$ 32,255</b>	<b>68,921</b>	<b>78,347</b>	<b>157,917</b>
<b>Interest income:</b>				
Restaurants	\$ 16,484	16,989	35,988	31,417
Franchising and other	50	1,408	1,112	2,777
<b>Total interest income</b>	<b>\$ 16,534</b>	<b>18,397</b>	<b>37,100</b>	<b>34,194</b>
<b>Income before income tax expense:</b>				
Restaurants	\$ 193,212	345,298	119,782	218,237
Franchising and other	41,024	44,474	127,591	68,443
<b>Total income before income tax expense</b>	<b>\$ 234,236</b>	<b>389,772</b>	<b>247,373</b>	<b>286,680</b>

	June 30, 2006	June 30, 2005
Total assets:		
Restaurants	\$ 10,231,942	10,378,918
Franchising and other	3,851,423	5,217,926
Total assets	\$ 14,083,365	15,596,844

**(8) 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 June 30, 2006, the Company has accrued \$100,000 related to the items discussed below.

**Little Rock, Arkansas Lease**

On June 30, 2006 the Company's lease of four restaurant premises in the Little Rock, Arkansas, metropolitan area, expired. The Company had subleased three of the four leased premises. The owner/landlord of the Little Rock premises has asserted that the Company will be responsible for certain repair and maintenance expenses for the premises, and for the replacement of certain equipment. One of the Company's subtenants may assert some claim against the Company for termination of the Lease prior to the expiration of its sublease. The Company has certain claims against the owner/landlord arising out of the lease relationship. All parties are currently engaged in discussions to determine and satisfy the respective obligations of the parties and to resolve any and all possible claims. The Company has accrued an amount that it believes is a reasonable estimate of its obligation under the lease.

**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 \$3,548,000 through December 31, 2005.

While the Company disputes any liability for any of the following amounts, to the Company's knowledge, as of June 30, 2006 a total of approximately \$2,850,000 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.

#### **(9) 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. There has been no change in estimate as of June 30, 2006, the lease termination date.

#### **(10) 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.

#### **(11) 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 June 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 \$67,873 and \$76,979 for the three and six months ended June 30, 2006 is included in equity in loss of unconsolidated joint venture. The restaurant is scheduled to open during the fourth quarter of 2006.

**Financial Data**

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

	<b>Three Months Ended June 30, 2006 (unaudited)</b>	<b>Six Months Ended June 30, 2006 (unaudited)</b>
<b>Statement of Operations Data:</b>		
Total revenues	\$	\$
Prototype plan expense	5,226	10,963
Interest	8,227	14,563
Net loss	(67,873)	(76,979)
<b>Balance Sheet Data:</b>		
Cash		\$ 16,730
Land and leasehold improvements		1,299,910
Loan costs, net		14,233
Total assets		1,331,805
Loan payable		691,681
Accounts payable and accrued expenses		11,503
Members' equity		479,785

**(12) 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.

**(13) Subsequent Event**

Subsequent to June 30, 2006, the Company has invested in marketable securities including the use of margin accounts to purchase such securities. The investments have been made by Mr. Biglari, the Company's Chairman, subject to various limitations and reporting requirements set by the Board of Directors.

**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 135 restaurants located in 19 states, including 5 Company-owned and 130 franchise restaurants as of June 30, 2006. The restaurants include a family steakhouse concept and a steak and buffet concept.

### **Corporate Strategy**

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 focus on franchising restaurants and has made efforts beginning in the second quarter of 2006 on marketing the Wood Grill by Western Sizzlin buffet concept. Wood Grill by Western Sizzlin is very similar to the Great American Buffet Company-operated restaurants.

The Board of Directors delegated authority to its Chairman, Sardar Biglari, to make capital allocation and investment decisions concerning the Company's surplus cash, subject to various limitations and reporting requirements set by the Board and/or the Audit & Finance Committee of the Board. Mr. Biglari is also the Chairman and Chief Executive Officer of Biglari Capital Corp., an investment advisory firm that is the general partner of The Lion Fund, LP, a private investment fund. None of Mr. Biglari, Biglari Capital Corp., or The Lion Fund, LP will receive any compensation for any such investment activities undertaken on behalf of the Company. The Lion Fund, LP beneficially owned approximately 24.3% of the Company's outstanding common stock as of June 30, 2006. As of the date of this filing, Mr. Biglari has authority to manage surplus cash up to \$2.5 million, and, in addition, has authority to borrow a maximum of \$1 million towards making additional investments. The Company is currently investing in marketable securities. Investments were made subsequent to June 30, 2006.

To clarify the expectations that the Board of Directors has with respect to the investment of the Company's surplus cash, the Board has renounced, in accordance with Delaware law, any interest or expectancy of the Company associated with any investment opportunities in securities that may come to the attention of Mr. Biglari or any employee, officer, director or adviser to Biglari Capital Corp., and/or The Lion Fund, LP, and their affiliated investment entities, if any, who also serves as an officer or director of the Company (each a "covered party") other than (a) investment opportunities that come to such covered party's attention directly and exclusively in such covered party's capacity as a director, officer or employee of the Company, (b) control investments in companies in the restaurant industry, and (c) investment opportunities in companies or assets with a significant role in the Company's restaurant businesses including investment in real estate currently leased by the Company or its franchisees, or in suppliers for which the Company is a substantial customer representing over 10% of such companies' revenues but excluding pre-existing investments of Mr. Biglari, Biglari Capital Corp. and/or The Lion Fund, LP, as of July 11, 2006, the date of the Board's delegation of authority.

The remodeling of two Company-operated locations in Northern Virginia is complete. The Chantilly, Virginia location, originally planned as a location for a Company-operated restaurant opening in 2006, is currently being marketed as a franchised location. The Western Sizzlin Flamekist Grill joint venture project in Fayetteville, Georgia has been abandoned. The Company had incurred approximately \$75,000 in expenses on the Flamekist Grill project to date. The Company continues to research the Flamekist Grill concept as a franchise model for potential investors in our brand, but has no commitments at this time.

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 June 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.

### Equity Price Risk

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.

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.

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.

### Results of Operations

Net income for the three and six months ended June 30, 2006 was \$143,106 and \$149,404 compared to net income of \$242,025 and \$175,444 for the three and six months ended June 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 Ended June 30, 2006		Six Months Ended June 30, 2005	
Revenues:				
Company-operated restaurants	75.9 %	77.6 %	74.2 %	76.8 %
Franchise royalties and fees	22.1	20.3	23.6	21.0
Other sales	2.0	2.1	2.2	2.2
Total revenues	100.0	100.0	100.0	100.0
Cost of company-operated restaurants	48.6	51.0	49.8	51.3
Cost of franchise operations	11.1	7.9	11.0	8.8
Other cost of operations	1.9	1.4	1.9	1.6
Restaurant operating expenses	15.5	15.4	15.7	16.8
General and administrative	11.4	11.7	11.2	11.2
Depreciation and amortization	5.6	5.0	5.9	5.3
Closed store expenses				3.4
Gain on settlement of insurance claims				(2.1 )
Total costs and expenses	94.1	92.4	95.5	96.3
Income from operations	5.9	7.6	4.5	3.7
Other income (expense)	(.9 )	(0.5 )	(1.7 )	(.9 )
Income before income tax expense	5.0	7.1	2.8	2.8
Income tax expense	1.9	2.7	1.1	1.1
Net income	3.1 %	4.4 %	1.7 %	1.7 %



	Three Months		Six Months	
	Ended June 30, 2006	2005	Ended June 30, 2006	2005
<b>Restaurant Data</b>				
Number of Company-Operated Restaurants:				
Beginning of period	5	6	5	7
Opened				
Closed				1
Franchised				
End of period	5	6	5	6
Number of U.S. Franchised Restaurants:				
Beginning of period	133	146	135	147
Opened		2		2
Closed	3	4	5	5
End of period	130	144	130	144

## Revenues

Company-operated restaurants revenues decreased by \$644,250 (15.3%) to \$3.6 million for the three months ended June 30, 2006 as compared to \$4.2 million for the comparable three months ended June 30, 2005. Revenues for Company-Operated restaurants decreased \$1.4 million (17.5%) to \$6.6 million for the six months ended June 30, 2006 as compared to \$8.0 million for the comparable six months ended June 30, 2005. The decreases are largely attributable to the closing of a Company-operated location in February 2005, resulting in approximately \$180,000 in lost revenues for the six months ended June 30, 2006, a closing of a Company-operated location in July 2005 due to a total loss by fire casualty resulting in approximately \$506,000 in lost revenues for the six months ended June 30, 2006, and the temporary closing of a Company-operated location in Northern Virginia for three weeks during the six months ended June 30, 2006 for remodel. Additionally, same store sales for the three months ended June 30, 2006 experienced an increase of .74% and a decrease of .95% for the six months ended June 30, 2006, excluding the comparable results of the Manassas, Virginia location which was under remodel during the first quarter of 2006.

Franchise and other revenues decreased 6.9% to \$1.1 million for the three months ended June 30, 2006 as compared to \$1.2 million for the comparable three months ended June 30, 2005. Franchise and other revenues decreased 5.4% to \$2.3 million for the six months ended June 30, 2006 as compared to \$2.4 million for the six months ended June 30, 2005. The decreases are attributable to fewer franchised units in the system at June 30, 2006 as compared to June 30, 2005. Same store sales for the three and six months ended June 30, 2006, experienced an overall increase of 3.15% and 2.57%, respectively.

## Costs and Expenses

Cost of Company-operated restaurants, consisting primarily of food, beverage, and employee costs decreased \$486,000 (17.5%) to \$2.3 million for the three months ended June 30, 2006 from \$2.8 million for the three months ended June 30, 2005. These costs for the three month periods decreased as a percentage of total revenues from 51.0% in 2005 to 48.6% in 2006. For the six month period ended June 30, 2006, cost of Company-operated restaurants decreased \$921,000 (17.3%) to \$4.4 million from \$5.3 million in 2005. These costs for the six month periods decreased as a percentage of total revenues from 51.3% in 2005 to 49.8% in 2006. The decrease in the costs were largely attributable to the closing of a Company-operated location in February 2005 and the closing due to a fire of a Company-operated location in July 2005.

Cost of franchise operations and other cost of operations were \$610,000 for the three months ended June 30, 2006 compared to \$507,000 in 2005, and were 13.0% and 9.3% as a percentage of total revenues for 2006 and 2005, respectively. Cost of franchise operations and other cost of operations were \$1,143,000 and \$1,089,000 for the six month periods ended June 30, 2006 and 2005, respectively, and were 12.9% and 10.4% as a percentage of total revenues, respectively. The increase is largely due to the accrual of severance packages due to layoffs during the three months ended June 30, 2006 of approximately \$54,000.

Restaurant operating expenses, which include utilities, insurance, maintenance, rent and other such costs of the Company-operated restaurants, decreased by \$105,000 (12.54%) for the three months ended June 30, 2006 versus the prior year's comparable period. These costs for the three month periods were comparable as a percentage of total revenues from 15.4% in 2005 to 15.5% in 2006. For the six months ended June 30, 2006, restaurant operating expenses decreased by \$352,000 (20.2%) versus the prior year's comparable period. These costs for the six month periods were comparable as a percentage of total revenues at 15.7% in 2006 and 16.8% in 2005. The decreases are attributable to closing a Company-operated location in February 2005.

For the three months ended June 30, 2006 and 2005, general and administrative expenses were \$539,000 and \$636,000, respectively and as a percentage of total revenue were 11.4% and 11.7%, respectively. For the six months ended June 30, 2006 and 2005, general and administrative expenses were \$996,000 and \$1.2 million, respectively, and as percentage of total revenues were 11.2% for both periods then ended. The decreases were primarily due to legal fees associated with litigation matters incurred in 2005 and write off of leasehold improvements associated with closed stores in 2005.

Depreciation and amortization expense was \$7,000 (2.5%) less for the three months ended June 30, 2006 versus the three months ended June 30, 2005 and \$25,000 (4.6%) less for the comparable six month period then ended. The decreases were attributable to certain property and equipment becoming fully depreciated.

Closed store expenses were \$0 and \$350,000 for the three and six months ended June 30, 2005 and 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.

Gain on the settlement of insurance claims of \$220,351 in the six months ended June 30, 2005 was attributable to insurance proceeds received on the Lawrenceville, Georgia casualty. There were no such gains during 2006.

## Other Income (Expense)

Interest expense decreased \$37,000 and \$80,000 for the three and six months ended June 30, 2006 over the comparable periods in 2005 due to the pay off of three loans during the first quarter of 2006. Prepayment penalties of \$63,000 and the write off of financing costs of \$30,000 were included in loss on early extinguishment of debt during the six months ended June 30, 2006. Interest income fluctuates according to the levels of available cash balances.

Other income decreased \$18,000 and \$6,000 for the three and six months ended June 30, 2006 over the comparable periods in 2005.

Income tax expense is directly affected by the levels of pretax income. The Company's effective tax rate was 38.9% and 39.6% for the three and six months ended June 30, 2006 and 37.9% and 38.8% for the same periods in 2005.

### **Liquidity and Capital Resources**

Historically, the Company has leased the majority of its restaurants and through a strategy of controlled growth has financed operations from operating cash flows, the utilization of the Company's line of credit and long-term debt provided by various lenders. The Company had working capital of \$2.3 million and \$2.0 million at June 30, 2006 and December 31, 2005, respectively.

Cash flows provided by operating activities were \$1.0 million in 2006 compared to \$440,000 in 2005. During 2005, cash flows provided by operations were primarily due to net income of \$175,000, depreciation and amortization of \$540,000, loss on sale/disposal of property and equipment \$360,000, offset by gain from fire casualty of \$220,000, increase in other assets of \$267,000 and decrease in accrued expenses of \$503,000. During 2006, cash flows provided by operations were primarily due to net income of \$149,000, depreciation and amortization of \$524,000, insurance proceeds of \$245,000, offset by a decrease in accrued expenses of \$277,000.

Net cash provided by investing activities of \$669,000 in 2006 and \$573,000 in 2005, was primarily for capital expenditures related to property and equipment for both periods presented and proceeds of \$785,000 and \$653,000 in 2006 and 2005, respectively, from fire casualties. Capital expenditures for the two remodels of Company-operated locations in Northern Virginia totaled \$350,000 for the six months ended June 30, 2006. The balance of the capital expenditures was for necessary replacement of equipment and leasehold improvements in the other three Company-operated locations. The Company's management anticipates that it will spend an additional \$500,000 for capital expenditures for the remaining six months of 2006.

Net cash used in financing activities of \$1.3 million in 2006 and \$923,000 in 2005 was for payments on long-term debt including the payoff of three loans during the first quarter of 2006, and a portion of insurance proceeds from fire casualty that was received in 2005, and fully submitted to the lender.

The Company's need for liquidity is to fund working capital requirements of its franchise operations, capital expenditures, and for general corporate purposes. The Company believes that these needs will be adequately funded by operating cash flows, credit terms by vendors, and borrowings under its existing line of credit. 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, which may include acquisitions, dispositions, restructuring, joint ventures, strategic alliances, and other forms of partnership.

The Company's liquidity includes equity investments made by Mr. Biglari, Chairman of the Board. The practice of concentrating in a few issues, rather than diversifying, follows Mr. Biglari's investment philosophy and strategy. As previously discussed, the Board of Directors delegated authority to its Chairman to make capital allocation and investment decisions, subject to various limitations and reporting requirements.

### **CRITICAL ACCOUNTING POLICIES**

Our 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. We are not currently aware of any reasonably likely events or circumstance that would result in materially different results. Our 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*

We collect royalties, and in some cases rent, from franchisees. We view 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, we consider the age of the receivable, the financial stability of the franchisee, discussions that may have occurred with the franchisee and our judgment as to the overall collectibility of the receivable from the franchisee. In addition, we establish 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, we might have to increase the allowance for doubtful accounts.

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

We view the determination of the carrying value of long-lived assets, franchise royalty contracts and goodwill as critical accounting estimates since we must evaluate the estimated economic useful life in order to properly depreciate or amortize our long-lived assets and franchise royalty contracts and because we 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*

We view 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.

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

The Company does not engage in derivative financial instruments or derivative commodity instruments. As of June 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 June 30, 2006 (dollars in thousands):

**EXPECTED MATURITY DATE**

	2006	2007	2008	2009	2010	Thereafter	Total	Estimated Fair Value
Long-term debt								
Fixed Rate	\$ 176	\$ 163	\$ 119	\$ 110	\$ 121	\$ 335	\$ 1,024	\$ 1,051
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 June 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.

**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 below, 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 set forth below 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.

**The Company is dependent on one key person for its investment and capital allocation decisions.**

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

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of the Stockholders held June 20, 2006, the following persons were elected to the Board of Directors for a one-year term, until the 2007 Annual Meeting of Stockholders, or until their successors are elected and qualified:

Nominees	Shares voted for	Shares withheld
Sardar Biglari	526,251	125,781
Philip L. Cooley	528,690	123,343
Titus W. Greene	528,594	123,441
Thomas M. Hontzas	651,961	72
Jonathan Dash	528,690	123,343

Also at the Annual Meeting, discretionary authority for the Board of Directors to amend the Company's Restated Certificate of Incorporation to effect a reverse stock split at one of two ratios received the affirmative votes of a majority of the shares outstanding and was declared as approved and adopted. The votes were as follows:

Shares for	634,478
Shares against	1,053
Shares withheld	
Shares abstained	16,501
Non-votes	536,825



The above presentation of votes at the 2006 Annual Meeting of Stockholders has been adjusted to reflect the reverse stock split effective August 10, 2006 (Note 2).

Item 6. Exhibits

See Exhibit Index on page 26.

23

---

**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: August 14, 2006

**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.

25

---