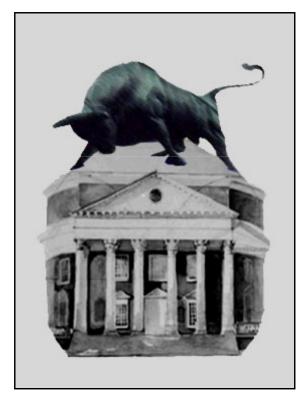
McIntire Investment Institute

At the University of Virginia



Long Pitch: Cracker Barrel Old Country Store, Inc. (NASDAQ: CBRL)

Prepared by Mark McDonald | 17 February 2009





History of Cracker Barrel

- First opened in 1969, and today there are 588 locations in 41 states.
- Founded by Dan Evins, while working for Shell Oil as a "jobber"
- Spent a lot of time traveling from town to town with his family, and understood the difficulties this presented
- His vision: restaurant, store, gas station
- Cracker Barrel Old Country Store went public in November 1981, it was reorganized in 1998 under CBRL Group



Business Overview I: Strategy

- -Today, Cracker Barrel is a joint restaurant/retail store that generated \$1.87 billion in revenue in 2008
- -The stores themselves are trademark rustic, old country store design with a separate retail area offering a wide variety of decorative and functional items featuring rocking chairs, holiday and seadonal gifts and toys, apparel, cookware and foods, including various old fashioned candies and jellies.
- -The restaurant portion of Cracker Barrel generated approximately 79% of total revenue in 2008, offer home-style country cooking featuring Cracker Barrel's own recipes that emphasize authenticity and quality.
- -86% of locations are on the interstate, 67% off-interstate locations planned in FY09
- -Serve breakfast, lunch, and dinner (breakfast available all day long)



Pictures



Pictures



Pictures



Awards

•18th consecutive year: "Best Family Dining Restaurant" <u>Restaurants &</u> <u>Institutions</u> magazine

•7th consecutive year: The Most RV Friendly Sit-Down Restaurant in America

•Fortune's 4th Most Admired Food Service Company in 2008 (first among full service restaurants)

•#1 Restaurant in the Casual Dining Category in Meeting Customer Expectations: 2207 Competetive Advantage Report: Restaurants & Beverage by Kanbay Research Institute



Fun Facts

- Since it went public in 1999, Cracker Barrel has sold over 3 million CDs from it's retail store
- Rocking Chairs were their number one selling retail item. They sold 170,000 in fiscal 2008.
- Cracker Barrel served 122 million slices of bacon last year.
- Served 11 million orders of Chicken N' Dumplings in 2008.
- 86% of locations are on the interstate



Business Overview II: Operations

- Mission Statement: "Pleasing People"
- Cracker Barrel's are strategically located on the interstate, as 40% of patrons identify as travelers, while the other 60% are locals.
- Areas under development: south eastern states, Texas, and Arizona
- Meal as % of sales: 23% breakfast, 37% lunch, 40% dinner
- Average weekly traffic per store: 7,350
- Average check per guest: \$8.59
- Average number of employees per store: 104



SWOT Analysis

STRENGTHS

-Geographic Presence -Great Value -Loyal Customer Base -Strategic Location -Unique Business Model

WEAKNESSES

-Appeals primarily to an ageing demographic -Susceptible to commodity and gas prices -Inability to franchise -Do not serve alchohol -Specific menu

OPPORTUNITIES

-Programs using their geographic presence -West Coast expansion? -Development off of the interstate -Arizona, Texas, and Florida

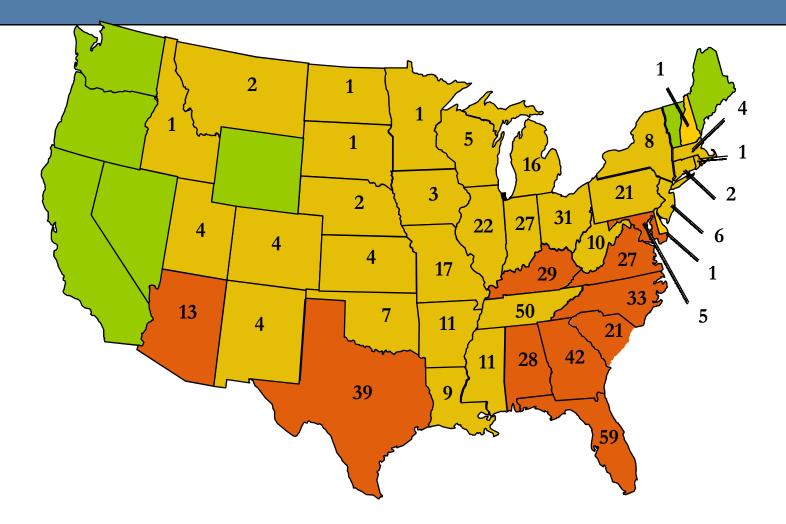
THREATS

MRRe

Old Country Store

-Competitors with similar geographic presence -Changing consumer preferences: healthier foods

Geographic Breakdown



Stock Overview

- Shares Outstanding: 22.39 million
- Market Cap: 434.66 million
- P/E ratio: 6.96 (compared to industry 2.98)
- Dividend yield: 4.12 (compared to industry .23)
- EPS: \$2.79
- 52-week high: \$38.87
- 52-week low: \$10.67
- 2008 dividend: \$0.74 (up from \$0.60 in 2007)

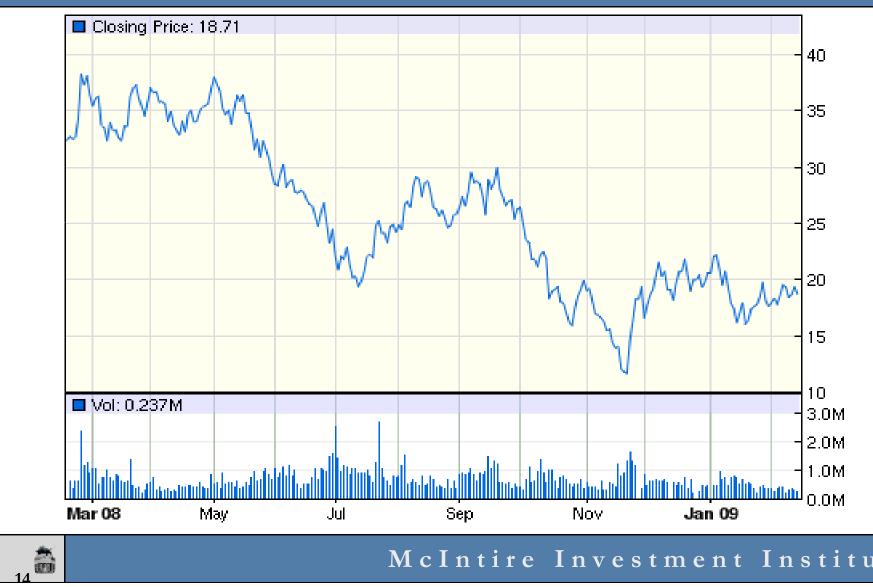


Thesis Points

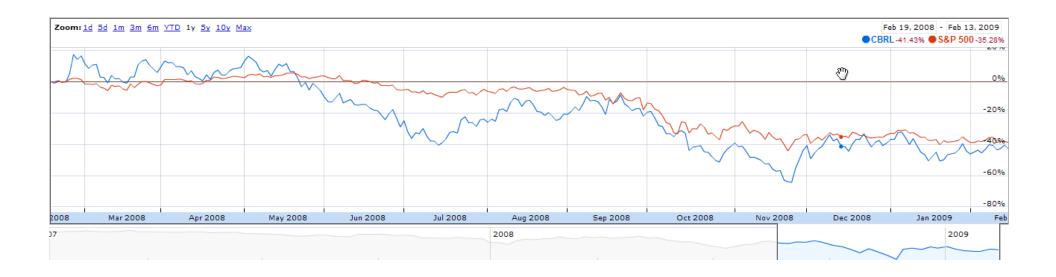
- 1. Strong Financials
- 2. Unique Business Model
- 3. Quality Management- Return Value to Shareholders



52-Week Stock Chart



52-Week Stock Chart





Thesis Point I: Strong Financials

- 1.87 Billion in revenue in 2008
- Gross Margin of 67.4%, compared to Industry Average 8.05%
- This gross margin has been very consistent- difficult given the volitile nature of commodity prices, (68.2% in 2006, 68.3% in 2007, 67.8% in 2008, 68.4% in Q1 2009)
- Return on Equity: 60.35
- Return on Assets: 4.85 (compare to industry .90)
- Return on Investment (5 year average): 7.78 (industry 3.4)



Valuation: Comps

- Valuation using comps:
 - P/E ratio: 6.96, shares outstanding: 2.39
 - 6.96*Net Income (12,832)= 89310= Market value of equity
 - 89,310/2,390= **\$37.36 per share**
 - Price to Sales Multiple=0.18
 - 0.18*revenue(573,932)=market cap= 103,307
 - 103,307/2,390= **\$43.22 per share**
 - Today's close:





However...

- What concerns me:
 - Starting in 2006, management began repurchasing shares.
 - Between 2006-2008 they repurchased 27.11 million shares
 - They felt the stock was undervalued and that they did not have the optimal capital structure
 - They have no intentions to repurchase more stock in 2009
- Now they are highly levered, total debt to equity: 801.04
- In 2006 they borrowed 1.25 billion to buy back shares. This signals that Cracker Barrel does not know where else to better invest money, hence they rather return money back to shareholders.



Thesis Point II: Unique Business Model

- Imitability: The Cracker Barrel Old Country Store is a complex business plan, which does not allow for franchising. On the other hand, it limits replication.
- Geographic presence allows for special programs like the "Audio Book Exchange Program"
 - In the works: DVD exchange program
 - Frequent traveler rewards program
- Quickly becoming an American Icon, Family-oriented
 - Both food and retail items bolster cross generational relationships
- Proven business plan: this year marks the restaurant/store's 40th anniversary





Other Strengths of Business Model

- Very appealing to older generation, menu consists of traditional southern style comfort food and the store retails nostalgically packaged goods
 - Potential for growth over the next 20 years with the ageing baby boomer and baby echo generations
- Voted number Most RV Friendly Sit-Down Restaurant in America (7th consecutive year)- offers great environment for large group (bus tours)
- In the 1991 U.S. recession, Cracker Barrel experienced profit gains (at that time it was recession proof)
- Loyal Clientele
- Growth Potential



Thesis Point III: Quality Management

Shane Finemore: Manikay Partners hedge fund, philosophy on strong management: The most important thing you needed to look at in valuing a company for a long is management. If it's a poor idea, good management will stop it early on. If it's great management that poor idea will be fairly discussed, but will never leave the ground.

- -At one point, every Vice President of Cracker Barrel was at one time a unit manager.
- -CEO Mike Woodhouse has been with Cracker Barrel for 13 years, he has spent 24 years in the restaurant industry
- -Terry Maxwell, Senior VP of retail, has been with Cracker Barrel for 28 years



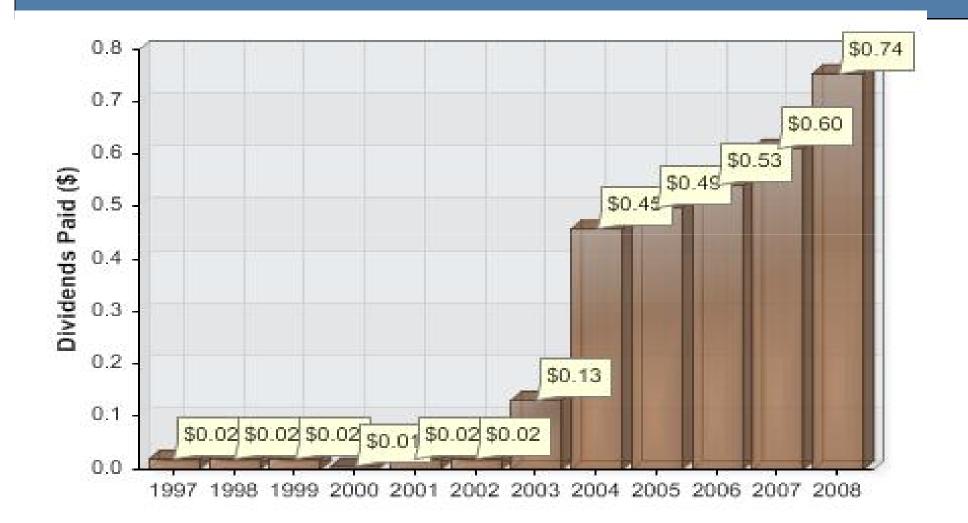
Quality Management

- Mission Statement: "Pleasing People"
 - This includes shareholders
- Intend to continue growing the quarterly dividend
 - See dividend yield and dividend growth graph
- Initiative to bring in fresh talent
 - Has resulted in the audio book program and the possibility of a more efficient menu that will be finalized on March 10, 2009 (could save the company \$500,000 annually in COGS)
- In 2007, they divested in Logan's Road House. Management has no intention to grow through anything other than Cracker Barrel Old Country Stores in the near future.





Dividend Growth





Value Added Research (VAR) I

- I. Jennifer Hodge, DineEquity, chief competitor
- II. Chris Clement, Unit Manager of Cracker Barrel Waynesboro, VA
- III. Janice Nedner, life-long Cracker Barrel customer Ivy, VA
- V. Pandu Sjahrir, MP Hedge Fund
- V. Jason Ramage, Former shareholder of Cracker Barrel



Jennifer Hodge, DineEquity, chief competitor

"We have a very strong presence across the United States, and even globally. Who hasn't heard of Appleby's and IHOP? It provides us with advertising and marketing benefits that other restaurant chains don't have. We have something for everyone on our menu. I don't think that every American knows what or where a Cracker Barrel is. Personally, I think that their business plan is kind of backwards. Yeah it's differentiated, but most people, when they go shopping to buy someone a gift, don't have Cracker Barrel in mind."



Chris Clement, Unit Manager of Cracker Barrel, Waynesboro, VA

On why people choose Cracker Barrel over competitors...

"I think it has a lot to do with our people. We offer a hospitable, friendly, open environment for our customers, and our business has been able to replicate that feeling across all 580 stores...Also, our chicken dumplings.."



Chris Clement, Unit Manager of Cracker Barrel, Waynesboro, VA

"I think our corporate culture resonates all the way down through our unit managers and employees. It's a familial culture and our customer's see that. Every single VP at this company was at one time a unit manager of one of our stores, so we have very experienced management. At the same time, corporate, as of recent, has made efforts to bring in fresh talent, because we don't want to become stale. I've been with Cracker Barrel for the last fifteen years, I've fully bought into this ideology and I have no intention on leaving."



Janice Nedner, life-long Cracker Barrel patron

"I think people like Cracker Barrel because it's hard to get that kind of food in that kind of environment. Maybe you want a huge platter of deep-fried, brown food but you don't want to go somewhere too trashy. I think that's why those awful chain Tex-Mex places thrive; because people don't necessarily want to go down to the taco cart with their whole family in tow."



Pandu Sjahrir, MP Hedge Fund

CBRL is a restaurant first and foremost targeting the older crowd with check in the \$9-\$10 range (which in my book ought to be pretty ok in this downturn). However, the other part of their business lies in their stores, which frankly sells mostly discretionary items that can only be sold during the boom years. They will face headwinds in this part of the business. Further, their business is heavily dependent on interstate highway, and given people's willingness to travel, has become much less pronounced than before. So there are two big macro-headwinds facing them.

Another thing I am concerned about is management selling for the past 4 years. There has not been much management direct purchase on the stock. Management typically says this as a diversification purpose, though the fact that there is lack of purchase of the stock is not a good signal to me.



Jason Ramage, Former Shareholder of CBRL, Blogger: The Motley Fool

Hi Mark,

I actually don't own Cracker Barrel shares any more. I sold my holding in the fall, mostly because I decided their growth outlook wasn't looking so good over the next few years. Of course, a great buying opportunity came along there in November when the shares fell to about \$12, but it jumped back up before I was able to pounce on it. With a stable, dependable company like this one, I would take advantage of any dips below \$15 in the future, just because Cracker Barrel has a strong following of regulars who will keep coming back. Unless the economy seriously goes sour, that's not going to change.

I suppose as a relatively regular customer I still qualify as a stakeholder.



Summary of My Concerns:

- I. 60% of customers are locals, 40% of customers are travelers. Volatility in gas prices presents fluctuating revenues
- II. Health consciousness trends in the U.S.III. Appeals strongly to the ageing generationIV. Susceptible to volatile commodity pricesV. Lack of management direct purchasesVI. Overleveraging



Recommendation:

- Recommendation:
 - No other restaurants currently in MII's portfolio- allowing for diversification
 - Short case for Cracker Barrel (20.67% short float)
 - Potential: debt undervalued and equity overvalued
 - If we are willing to take the risk, I suggest we wait, watch this stock, if it drops below \$15, make a 5% buy-in and hold for long term growth
 - Personal Stake

