



Opportunity Equity Research

Diversified Restaurant Holdings (SAUC)

Initiation Report (11/15/2017)

Diversified Restaurant (SAUC) Stats

\$ 1.60 Current Price

\$ 43 Million Market Cap

52 Week Range \$1.04 -\$4.12

Shares Outstanding: 26.9 mil

Enterprise Value: \$153.9 mil

Debt: \$117 mil

Institutional Holdings: 14.6%

Insider Holdings: 49.6%

Short Interest: 59.3k/.44%

30 Day Avg Volume: 45.9k

Condensed Income Statement

FY (Dec)	Q1	Q2	Q3	Q4	Yr
EPS 16a	\$.05a	\$.02a	-\$0.04a	\$.01a	\$.16a
EPS 17e	\$.03a	\$.00a	-\$0.00a	-\$0.02e	\$.01e
EPS 18e	\$.05e	\$.01e	\$.01e	\$.01e	\$.09e
Rev16a	\$43.1a	\$41.0a	\$46.7a	\$40.8a	\$166.5a
Rev17e	\$44.3a	\$39.9a	\$39.3a	\$42.7e	\$166.0e
Rev18e	\$43.9e	\$40.4e	\$39.6e	\$38.1e	\$162.0e

EV/2016 Rev: .92 times Cap/2016 Rev: .24 times

SAUC Chart-6 Month View



SAUC Chart-5 Year Look



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Company Description: Diversified Restaurant Holdings is the largest Buffalo Wild Wings Franchisee, owning 65 locations with large geographical exposure in Michigan, Indiana, Illinois, Missouri and Florida. After taking on substantial debt to acquire a large footprint in the St. Louis market, SAUC spun-off their Bagger Dave's hamburger chain at the end of 2016 to become a pure-play BWW franchisee.

Opportunity Summary: Post a fairly recent spin off of Bagger Dave's, SAUC becomes a much "cleaner story" and a very focused BWW restaurant operator. Although recent commodity and wage pressure coupled with a large debt level have placed near term challenges on the current management team, focused efforts on cost control, debt paydown and future growth opportunities make this stock worth a look at these levels.

- The board and management team has recently hired Duff & Phelps to assist with exploring strategic alternatives, including a restructuring or possible sale, merger of other strategic transaction- a wildcard but with potential positive effects.
- Although debt levels are large, management has been using cash flow to pay this down and would like to be at 4* debt/EBITDA level (methodical paydown).
- Management focus on cost control, particularly with the massive rise in chicken wing prices (up 48% year over year recently), will be key to short term bottom-line results.
- Adding delivery service, slowly remodeling older locations, pursuing selective smart acquisitions, and adding greenfield sites over time all should help with long term revenue growth.
- With a \$154 million enterprise value and only a \$43 million market cap, the game plan to pay down debt and incrementally add restaurants over time could lead to significant equity gains.
- Current mature and larger restaurant chains trade in the 3-6+ times Enterprise Value/Revenue range. Trading at less than 1 times trailing EV/revenue, patient investors could see very nice returns in SAUC stock in the long term.

CEO Name: David Burke, President and CEO

CFO Name: Phyllis Knight

IR Contact: Craig Mychajluk, KEI Advisors 716-843-3832

Company Overview/History:

Diversified Restaurant Holdings was incorporated in September of 2006 and was founded by Thomas Ansley (currently a 41.3% stockholder of SAUC). Post an IPO in March of 2008, Diversified Restaurant Holdings operated as “Bagger Dave’s” with the potential growth driver of the company being the Bagger Dave’s Burger Tavern concept (they also owned BWW franchises as well in the same trade area). The company had its IPO in 2008 and followed with a \$32 million equity capital raise in 2013.

After ramping the Bagger Dave’s concept for a number of years and seeing opportunities to also grow within the Buffalo Wild Wings concept, management decided to spin off the Bagger Dave’s concept as its own separate company and become a pure-play BWW franchisee (completed in December of last year). Bagger Dave’s was distributed on a share for share basis to holders of SAUC stock in December 2016. In this transaction, SAUC retained all the debt, but was able to keep \$22 million in tax loss carryforwards that the management estimates to potentially offset over \$40 million in future earnings.

The Diversified Restaurant Holdings of today is a pure play BWW franchisee and currently owns 65 of Buffalo Wild Wings’ 611 franchised locations (11% of their franchise network, BWW has a total of over 1,200 restaurants nationwide). Buffalo Wild Wings currently sports over a \$1.85 billion market valuation on those 1,200 locations. The BWW concept is sports focused with a large bar menu with their featured chicken wings and sauces (with \$22-\$25 average check sizes).

SAUC added 43 BWW locations over the past 6 or so years, with the largest additions coming from a 2015 opportunistic acquisition of 18 BWW locations in the St. Louis market in a fully levered \$54 million deal. They are open to further growth from both greenfield restaurants located within or near their current footprint or through acquisitions of other BWW franchisees in locations that benefit their network. The parent Buffalo Wild Wings has been pressured lately through activist investors to become more of a franchise based model, and the parent company has

noted that it is looking to sell up to 10% of its franchisee network; starting with 83 of its company owned restaurants in certain geographies (sounds like not the best opportunities, lower than SAUC’s typical restaurant level margins at only high single digits). Although this could provide multiple growth opportunities for SAUC over time, the current multiples BWW wants for those locations, their geography and SAUC’s current high debt levels make near-term acquisitions unlikely.

In a recent development, the board and the management team announced that they had hired Duff & Phelps to explore strategic alternatives, including among other things, “financial restructuring or possible sale, merger or other strategic transactions.” Although it can only be speculated where this initiative will eventually take them, recent management guidance (in a very tough environment) is for \$20 million in adjusted EBITDA for the current calendar year with total debt levels standing at \$116.8 million. Although Buffalo Wild Wings may make the most sense as a potential acquirer of any of SAUC’s locations or geographic areas, they have recently been actively moving to get more of their locations refranchised. Other franchisors of Buffalo Wild Wings might also be potential acquirers of either single units or areas owned by SAUC.

Another potential outcome of this recent news may be that the management team simply realizes that they are doing everything they can to manage through the recent tough times they have been seeing (including large COGS pressure, weather hits including the recent Florida hurricanes, tough comps for their sports teams, employee wage pressure and competitive discounting). One conclusion to this is that they should simply remain hunkered down—continue to focus on restaurant level operating results, continue to hold expenses to a minimum, and continue to pay down debt. Current valuation is compelling if that is the decision.

A number of things may improve for SAUC in the near future. They are moving in to easier comps, chicken wing price pressure has begun to subside, management has been showing strong ability to control costs, and debt is slowly being paid off.

Management Profile:

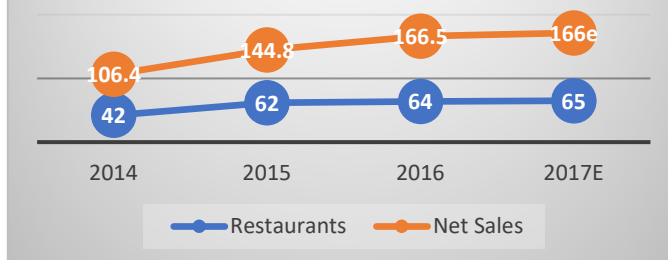
David Burke is the current President and CEO of Diversified Restaurant Holdings, being appointed to those roles in October of 2016 after serving as the CFO and Treasurer since 2010. Phyllis Knight, CFO, also assumed her role in October of 2016 and claims 30 years of finance and accounting experience at Polar Corporation and Champion Enterprises. Jason Curtis is the COO and has served in that position since 2002, gaining experience through the company's IPO, growth and the spin-off of Bagger Dave's. Thomas Ansley (founder), David Burke and Jason Curtis have all been officers at the company for 12 years.

There are a number of things that strike me about this management team that I like. I definitely get the sense that the debt paydown is the key priority that they will not veer from. I also believe that any further acquisitions within the BWW footprint will be on their terms, and they will be purchasing units that are decent volume locations that can add to their company wide margin potential. Going forward, they don't seem eager to add additional debt in the name of future unit growth, and they realize that buying BWW locations with poor total revenue/location could be a recipe for disaster (they don't feel like they are turnaround experts).

There is a very solid focus on unit economics, controlling costs, and paying off debt. You hear it in their quarterly conference calls and you see it in the results. The entire restaurant industry has been under considerable traffic, wage and commodity cost pressure. The best management teams will guide their units through this pressure, focusing on what they can control and manage while looking for growth opportunities that may benefit them as the restaurant group comes out of this rough stretch.

Management has recently announced new "aggressive targets" to management incentive plans that began in Q3 and reductions in salaries and support office expenses to help control the costs that they can in a difficult restaurant operating environment.

Restaurants/Net Sales SAUC



Above: SAUC's Buffalo Wild Wing Restaurant Count and Net Sales growth for Diversified Restaurant Holdings since 2014, with an estimate for 2017.

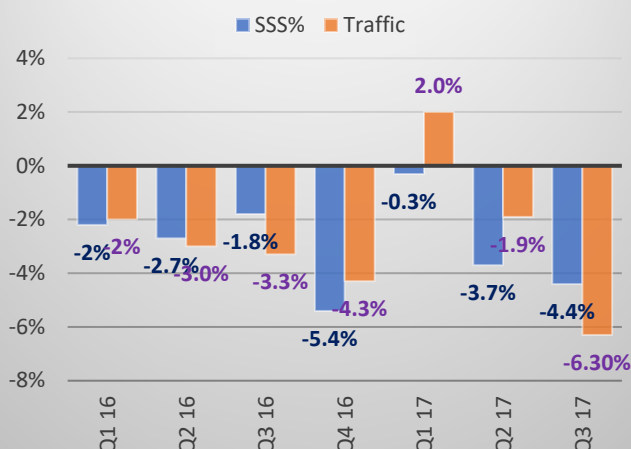
Growth Opportunities/Margin Profile:

The biggest recent jump in restaurant count for SAUC was the addition of 18 locations in St. Louis back in 2015. Since then, they have added just 3 locations in the past two years as the priority of the management team moved to 1) spinning off Bagger Dave's, and 2) using cash flow to pay down acquisition debt.

The entire restaurant industry has been hit with lower consumer spending on dining out, and Diversified Restaurant Holdings was no exception. System wide same store comps turned negative back in Q1 of 2016.

In quarterly results two quarters back, management talked about a roughly -200 basis point hit to same store sales from an unfavorable sports environment in their core markets. They went from having 60 NHL/NBA games in their home markets to just 20 this year (they will also be lapping the move last year of the Rams out of their St. Louis market). Although these hits are temporary and can change from year to year, it's important to note that in Q3 of 2016 the management was also talking about the KC Royals and the St. Louis Cardinals not doing as well as they did in 2015. There will always be ebbs and flows on these results that will temporarily help or hurt any quarter's results. Same store sales trends have been tough, but they are circling in to easier comps this upcoming Q4 (see next page).

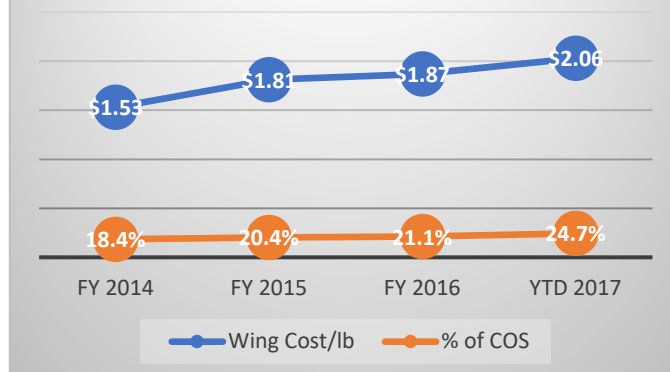
Same Store Sales and Traffic Trends



Restaurant level EBITDA margins across their network have consistently been in the 19-21%+ range, very strong margins for a restaurant concept. Over these past four quarters, SAUC has experienced a spike in one of their key food offerings, with jumbo chicken wing pricing spiking starting Q4 of 2016. Chicken wing costs have historically been in the 19.5-21% of total sales range for the company. Back in Q4 of 2016, wing costs spiked suddenly to become 23.5% of total cost of sales that quarter, only to remain stubbornly high and reach 24%, 24.9%, and 25.3% of sales the most recent quarters.

To give you a feel, wing cost per pound was only \$1.53/lb back in FY2014, while year to date in 2017 it has reached \$2.03/lb. Early Q3 prices were noted as being at record high levels of \$2.09/lb at one point, and it appears that most industry observers feel they will stay at these levels given strong underlying demand for the product and limited supply that can't be adjusted by chicken producers quickly. Recent price trends on this front include five weeks of price decreases with spot currently at \$1.90/lb. Management has noted that they are optimistic that they've seen the worst of the pricing pressure here, and "given the current promotional structure and mix, this decrease in prices is expected to contribute about 1 full point to gross margins in Q4 relative to Q3." Another small positive from recent quarterly results is that average check grew +1.9%.

Wing Cost Pressure



A 179 basis point increase in cost of sales in this past quarter had 209 basis points coming from the chicken wing price increase alone. Because of commodity cost pressure as well as the effect of sales deleveraging, SAUC saw its restaurant EBITDA levels move from the historical 19-21% range to 16.5% in Q4 of last year, then 19% in Q1, 16.6% in Q2 and 15.9% in Q3. Management is doing a number of things to combat the negative wing cost trend, including changing their half off wings Tuesday promotion to a BOGO offering (doubling the smaller wing offerings which carry higher margins). They also are adjusting portion sizes to combat the margin pressure (started this in early June).

In mid May they took a 1.8% menu increase along with a +5% increase in alcohol and +10% increase in delivery pricing (after taking very little price during 2016). They talked about potential to take some price in the November time frame as well if they feel it is necessary and prudent. They are also planning on offering BOGO boneless promotions in Chicago and the northern Michigan markets post successful testing of that promotion by the parent company.

We'll see over time how much these moves can offset the commodity pressure, but what investors do know is that the management is taking action to offset the changes and that they have been implementing these moves for some time now. It's also important to note that wing prices have been volatile historically and have come back down, so either normalization of this cost environment (where management initiatives can have a margin effect over time) or a return to more historical

chicken wing pricing could both help SAUC's restaurant level margins.

Management has also highlighted a target for G&A expenses to be at 5% of sales by the second half of 2017 (historically in the mid to high 5s over these past three years), and has introduced new management incentive plans starting in Q3 2017 that are focused on helping with sales costs. The management team was able to hit this goal in recent results coming in with an SG&A level of 4.9%. Time will tell if the historically high wing prices will stay at these levels for a considerable period of time, but what we do know is that the management and restaurants have now had time to adjust to these increases and the company is facing its last really tough comps in terms of wing cost increases year over year.

On a different front, while Carry-Out sales have been pretty consistent at around 20% of total sales throughout their network, in Q3 of 2016 management started adding delivery service to their mix. It started at just 1.9% of that quarter's sales and has increased to 2.7% of the mix during this past quarter. 38 of their 65 locations had delivery service available as of this past quarter, with an average delivery check being 13% higher than dine-in and 17% higher than carry-out. Although margin mix isn't quite as attractive (due to loss of incremental drink/alcohol/add-on sale margins), the incremental nature of this line is helpful in a tough restaurant environment.

The management also talked about adding to the pricing of delivery to offset the costs involved (there is typically around a 20% fee to the deliverer, management increased pricing on delivery orders by 10% to offset some of this added cost). Management doesn't believe they will see much pushback on these moves, as consumers view this as a real value add and are willing to pay for it. They also mentioned that these delivery sales carry an estimated incremental margin in the 50% range (very nice additional sales in a tough environment for now).

In addition to adding restaurant delivery capability, management has also been ramping their "Blazin' Rewards" loyalty program. From an initial launch in the St. Louis market back in 2016, they now have over

110,000 members with a check size 17% higher than non-loyalty members-they hope to continue to ramp this program to help entice their most loyal users to frequent the restaurants more often.

The most recent quarter brought management guidance for the year down to the \$166-168 million level with restaurant level EBITDA guide at \$28-29 million and adjusted EBITDA guide for the year to \$20 million. This was a reduction in anticipated topline by \$2-5 million and at the adjusted EBITDA level of \$2.5-4.5 million for the year.

Competitive Environment/Industry Thoughts:

Wage pressure has been another dynamic hitting the industry over recent years. Both the ability to find talent in more competitive markets and the "instant readjustment" to new labor costs with minimum wage increases (like Colorado's increase in their tip wage credit) puts pressure on all restauranteurs. Certain geographies also tend to get overbuilt. For SAUC, the exposure that they have in the Florida market is a highly competitive area. Management talked about overcapacity in the Florida market on a recent call, "everybody wants to go and open up a restaurant, a bar in Florida...but it continues to oversaturate." The competition is clearly fierce, yet Buffalo Wild Wings consistency across their restaurants and reliable food and sports focused offering helps make them stand apart. Recent same store sales performance also definitely had a distinct regional tone to it, with SAUC's restaurants in the Plains and Florida markets showing the weakest sss trends.

On a different front, with the increasing popularity of chicken wings, more and more restaurants and bars have added them to their menu (this is a large reason for the recent commodity increases). Although this makes the Buffalo Wild Wings concept a little less differentiated than other local offerings, consistency of the offering, variety of sauces and reliability of the format should keep customers coming. This is a blocking and tackling type of industry where management will continue to have to adjust to commodity and wage pressure and make sure their offering is relevant and desired.

Ownership Profile:

Diversified Restaurants has a heavy level of insider ownership (49.6%) with 41.3% of that still being held by the founder, Thomas Ansley. The CEO, CFO and COO own another approximately 5.4% combined. David Kanen owns 5.4%, and Renaissance Technology and Parkside Financial Bank & Trust own 2.7% and 1.2% respectively. Total institutional holdings are at a very low 14.6% (this becomes an opportunity as the company gets larger and gains more attention from the street). Short interest is an almost non-existent .44%.

I like the level of insider ownership, with the founder at a very high level of ownership and still clearly motivated to help his firm prosper and come up in the end with a long-term win for the stock. Both the CEO and CFO could use a bit more exposure to the stock over time.

The institutional ownership is also positive and important. 14.6% institutional exposure is very low and could end up substantially higher over time, the market cap is one mitigating factor, but I also believe this company is underfollowed post the spin-off.

Risk Profile:

Diversified Restaurant Holdings risk profile is similar to many smallcap restaurant names. Current pressures to restaurant company results include wage and commodity inflation (with a substantial increase in wing costs year over year being a particular current challenge).

There is risk that new units might be located in subpar or more expensive locations. Future growth from acquisitions is dependent on market supply, and price paid to add additional locations through acquisitions will be dependent on market dynamics at the time. Additional risk in the space comes from the general slightly negative trend in consumer spending seen in the restaurant space. SAUC also has a significant amount of debt from its 2015 acquisition that it will need to continue to pay off.

Investors should be aware of the limited liquidity of micro and small cap equities, which can work both for and against any investment.

The competitive environment in the restaurant industry is strong and varies by geography, with some locations such as the Florida market (for SAUC) being particularly competitive. Recent hurricane effects hit SAUC's top and bottom line results by approximately -\$600k on the topline (with roughly 25% exposure in the Florida market), and weather in any geography can negatively affect current results in a dramatic way in any given quarter (think winter storms in the Midwest).

An additional risk to this specific restaurant concept is the success (or lack thereof) of the sporting teams in the markets where they have exposure. Management has noted on recent calls that their markets have been difficult, with local sports teams seeing substantially less time in the championship levels of their sports (vs. recent historical trends). Although this can come and go in any year, they are being hit in a particularly negative way this year. This creates an easier comp next year with the possibility of upside to restaurant results if their teams do better next year.

Valuation:

Below is a look at SAUC's EV/Sales since the end of 2012. 2015 was the year that they did their large St. Louis BWW acquisition and added substantial debt relative to market cap to their balance sheet. Although it has recovered some from the 2016 lows, it has substantial room to grow to simply regain historical trading ranges and averages.



There are numerous public restaurant comparables to look at in trying to place a potential value on SAUC. Below is a look at SAUC vs. its parent company Buffalo Wild Wings (BWLD) and four other smaller public restaurant comps. A couple of things stand out.

If you look at the valuation both on a historical P/E standpoint and look at SAUC vs. the out year estimates from the street, SAUC has a great valuation vs. both its parent and other small (but larger than SAUC) public comps.

Stock	EV	P/E FY0	P/E FY1	P/E FY2
SAUC	154mil	10	NMF	17.8
BWLD	2234	31.3	23.8	21.3
ZOES	267	269	NA	NA
PBPB	267	44	36.8	33.2
TACO	625	27	22.4	20.7
RRGB	886	65	20.9	17.8

The FY1 P/E is “no meaningful figure” for SAUC because, among other factors, they have faced such large headwinds on commodity inflation this year. If chicken wing prices normalize (or the management just finds ways to cope over time with the higher costs with price rationalization and portion changes), SAUC should have a strong chance be recognized again for its earning power over time.

Stock	EV/Ebitda FY0	EV/Ebitda FY1 est.	EV/Rev FY0
SAUC	6.9	7.7	.92
BWLD	9.9	7.9	1.09
ZOES	22.2	10.0	.74
PBPB	8	6.8	.61
TACO	10.8	8.3	1.24
RRGB	8	6.0	.64

The chart above is another look at SAUC valuation vs. public comps. On an enterprise value/EBITDA ratio both historically (actuals) and estimated for this fiscal year, SAUC compares favorably to the group (with a number of them trading for multiples higher). Another kicker to the equity valuation on this stock in particular will come slowly over time. As SAUC continues to pay down the debt levels, enterprise value transfers to the equity component, and their EV/Revenue multiple should see upside or normalization closer to group levels.

www.diversifiedrestaurantholdings.com Company webpage/more information on the company/historical financials/links to IR/etc.

Historical SAUC Income Statement:

Diversified Restaurant Holdings Income Statement (in millions)										
	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Sales	128.4	144.8	43.1	46.4	46.7	40.8	166.5	44.3	39.9	39.3
(% sales growth year over year)	18%	13%	9%	26%	-1%	-4%	15%	2.8%	-14%	-5.7%
Cost of Goods Sold incl. D&A	37.1	40.7	12.06	13.06	12.9	11.9	46.8	13	11.9	11.6
Gross Income	91.4	104.1	31.1	33.3	33.8	28.9	119.7	31.3	28	27.7
(% gross income growth yoy)	0%	14%	11%	27%	1%	NA	15%	1%	-16%	-18%
SG&A Expense	52.8	57	15.6	18.9	19	15.5	62.5	16.3	15.4	15.3
(% SG&A growth yoy)	38%	12%	-3%	3%	-10%	NA	-2%	4%	-19%	-19%
Dep/Amort	11	11.9	3.8	4.4	5.2	3.5	14.7	3.6	3.3	3.2
Other Operating Expenses	27.2	31.3	8.6	9.7	10.2	9	34.8	9	8.4	8.8
Total Operating Expenses	129.1	142	40	45.4	47.5	40	159.2	42	39.2	38.9
Operating Income	-0.6	2.8	3.1	0.96	-0.8	0.85	7.3	2.4	0.7	0.3
Interest Expense	-2.3	-4.2	-1.44	-1.44	-1.44	-1.44	-5.8	-1.58	-1.64	-1.82
Net Income b4 Extraord. Items	-1.3	-0.5	1.29	-0.18	-1.39	0.19	3.6	0.8	-0.29	-0.543
EPS (diluted) per share ex. Items	-0.05	-0.02	0.05	-0.01	-0.05	0.18	0.14	0.03	-0.01	-0.02
Normalized EBITDA	11.3	15.7	6.93	4.75	4.53	4.5	22.3	6	4.3	4.3

Potential investors might take a couple of things away from looking at the historical income statement. Revenues have been growing steadily at Diversified Restaurant Holdings with a large lift from the 2015 acquisition. If you look at SG&A trends, 2014 expenses grew much faster than sales, but has since turned the other direction as management has slowed down unit growth and focused on cash and expense control. Importantly for the company's future, management has discussed how roughly 2/3 of their G&A spend is fixed, with the thought that they could grow to "well over 100 stores" on their current G&A in place without effecting the 2/3 fixed cost. This should provide nice margin leverage over time as they incrementally add to their store base.

Also notable is that very recent topline performance is down as the company continues to battle negative same store sales trends (with average check increasing +1.9% and traffic being down -6.3% last quarter). The company just went through its fourth really tough comparison quarter on chicken wing prices (wing cost was 25.3% of total cost of sales this past quarter, vs. 23.5%, 24% and 24.9% over the three prior quarters and vs. numbers in the 19% range the prior year). As they begin to anniversary the higher costs and pass them through on portion reduction initiatives and modified promotional activity, that pressure should lessen. Normalized EBITDA has been increasing steadily over the past few years, and continued focus on debt paydown from this stream should benefit the company and its stock in the future. Management recently guided to \$20 million in normalized EBITDA for the full year 2017.

Historical SAUC Balance Sheet:

Diversified Restaurant Holdings Balance Sheet (in millions)										
	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Assets										
Cash & Short Term Investments	21.6	13.5	5.3	5.5	4.3	4.0	4.0	5.4	3.8	4.7
Total Receivables-Net	1.4	0.2	0.8	0.5	0.5	0.3	0.3	0.1	0.1	0.1
Total Inventory	1.3	1.6	1.9	1.9	1.8	1.7	1.7	1.6	1.7	1.5
Total Current Assets	24.8	18.4	9.4	9.2	8.9	7.3	7.3	8.1	6.8	7.4
Gross Property, Plant and Equipment	103.8	92.0	123.3	125.6	126.1	100.2	100.2	102.0	102.1	102.1
Net Property, Plant and Equipment	71.5	59.3	82.3	81.2	78.0	56.6	56.6	54.8	53.1	50.7
Intangible Assets	2.9	2.8	3.5	3.4	3.3	2.7	2.7	2.6	2.5	2.5
Other Assets	3.3	35.2	15.2	15.8	15.5	16.5	16.5	16.6	17.4	18.2
Total Assets	113.4	165.8	160.6	159.6	155.9	133.2	133.2	132.2	130.0	128.9
Liabilities & SH Equity										
Accrued Expenses	4.1	4.6	5.3	5.9	4.5	5.4	5.4	4.9	4.5	4.2
Accounts Payable	7.0	6.0	7.4	5.6	5.7	4.0	4.0	4.1	3.9	5.1
Cur Portion LT Debt/Cap Leases	8.2	9.9	9.8	9.8	10.2	11.3	11.3	11.3	12.9	11.4
Total Current Liabilities	19.7	24.8	23.0	21.7	20.7	20.9	20.9	20.5	21.5	21.2
Long-Term Debt	53.6	116.4	112.3	112.5	111.1	109.9	109.9	119.6	118.1	105.4
Total Debt	61.8	126.3	122.1	122.3	121.3	121.2	121.2	119.6	118.1	116.8
Other Liabilities	7.0	8.0	9.2	9.9	9.3	6.5	6.5	6.2	6.6	6.0
Total Liabilities	80.3	149.2	144.5	144.0	141.1	137.3	137.3	135.0	133.4	132.5
Total Shareholder's Equity	33.2	16.6	16.1	15.6	14.8	-4.1	-4.1	-2.7	-3.4	-3.6
Total Liabilities & SHEquity	113.4	165.8	160.6	159.6	155.9	133.2	133.2	132.2	130.0	128.9

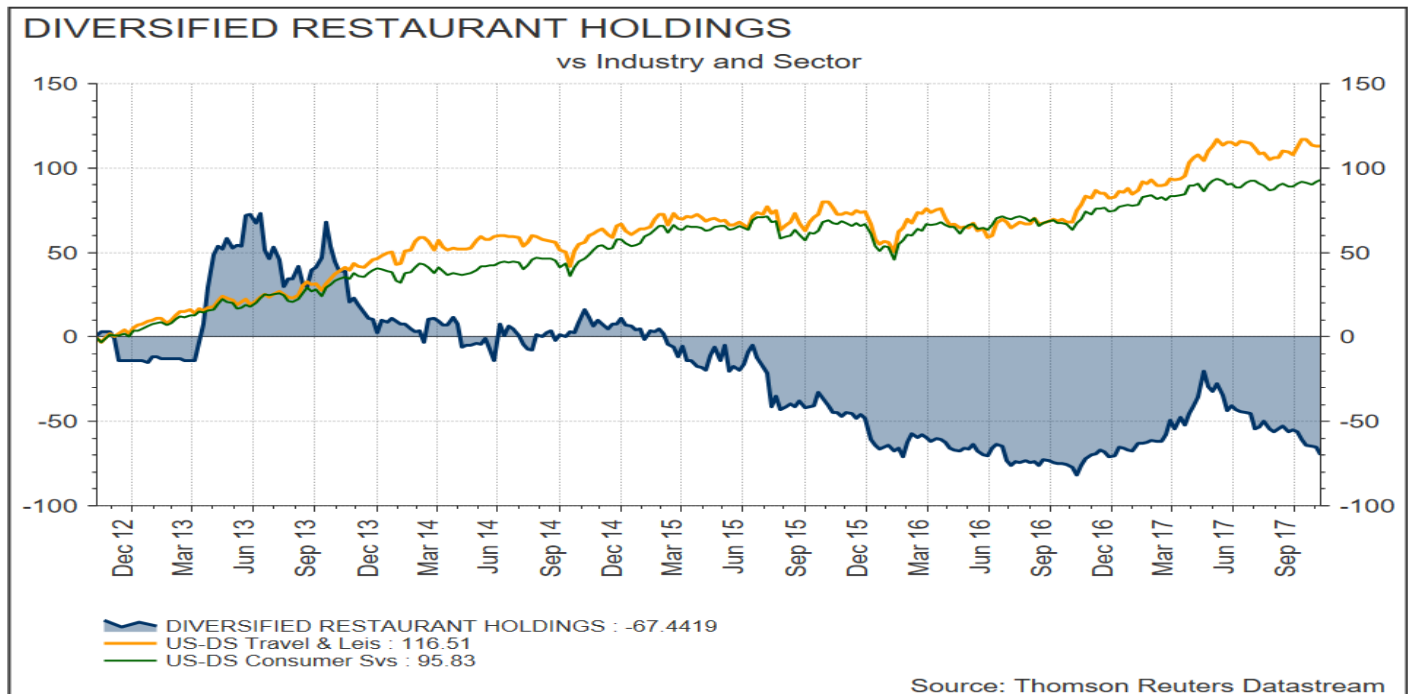
SAUC IPOd in 2008 and had a follow on equity offering raising \$32 million for the company back in 2013. If you look at the historical balance sheet, a couple of things stand out. Gross Property, Plant and Equipment took a step down at the end of last year with the Bagger Dave's spin-off, yet the company still has \$102 million gross and \$53 million net PP&E value. Cash burn has been steady over the years and has brought the company to the point where it has halted any major new greenfield builds, has held steady in terms of any new acquisitions, and has focused intently on cost control and cash management. The major debt pop happened back in 2015 with the St. Louis BWW acquisition, and they have a high yet manageable debt level (management recently guided to \$20 million in normalized EBITDA for 2017 with \$117 million current total debt level).

Management has discussed capex taking a back seat to debt paydown in the near term. In the longer term, they wish to convert over 30 units to the better operating Stadia design, with a price tag of roughly \$600 k/restaurant. This will happen over time and could lead to better unit economics at the redesigned sites, but this will take time as it is not a key near term priority.

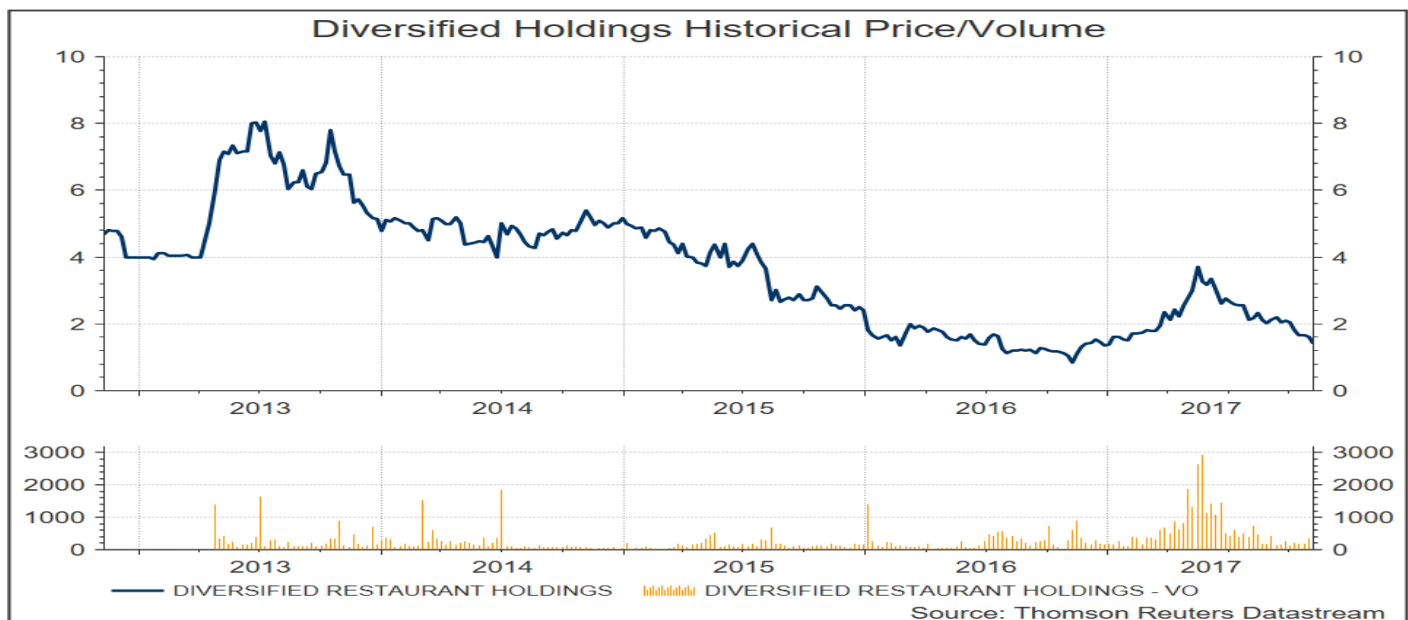
Historical SAUC Cash Flow Statement

Diversified Restaurant Holdings Cash Flow Statement (in millions)					
	2014	2015	2016	2017	2017
	Year	Year	Year	Q1	Q2
<u>Operating Activities</u>					
Net Income/Starting Line	-1.3	-16.2	-6.0	0.8	-0.4
Depreciation, Depletion, & Amort.	11.0	11.9	14.7	3.6	3.3
Deferred Taxes & Inv. Tax Credit	-1.8	-0.1	-2.3	0.0	-0.7
Discontinued Operations	0.0	7.8	3.8	0.0	0.0
Changes in Working Capital	1.7	3.9	0.0	-0.2	-0.6
Net Operating Cash Flow	11.3	8.9	11.1	4.4	2.0
<u>Investing Activities</u>					
Purchase of Fixed Assets	-39.0	-20.2	-12.5	-1.4	-2.1
Acquisition of Business	-3.2	-54.0	0.0	0.0	0.0
Sale/Maturity of Investments	13.1	3.0	0.0	0.0	0.0
Other Funds	19.1	-6.8	-0.9	0.0	0.0
Net Investing Cash Flow	-17.5	-78.0	-13.4	-1.4	-2.1
<u>Financing Activities</u>					
Change in Capital Stock	0.1	0.1	0.0	0.0	0.0
Cash Dividends Paid	0.0	0.0	-2.0	0.0	0.0
Issuance/Reduction of Debt, net	15.5	64.8	-5.0	-1.7	-1.5
Net Financing Cash Flow	15.3	64.1	-7.2	-1.7	-1.5
Net Change in Cash	9.1	-5.1	-9.5	1.4	-1.6
Free Cash Flow	-27.7	-11.3	-1.4	3.0	-0.1

The cash flow statement shows what you would expect from a high-growth small company, with a heavy use of cash for investing activities and increases in cash through equity and debt financing (last equity raise was 2013). In 2014 and 2015, SAUC issued a net \$80.3 million in debt, while starting the methodical paydown in 2016 with -\$5 million debt paid down and an additional -\$4.5 million year to date in 2017. With high debt to EBITDA levels, they need to continue to pay this down methodically like they have. For patient investors, the paydown of the debt over time will lead to the enterprise value being shifted to the equity component. Investors will need to pay attention to this debt paydown “blocking and tackling” by the management team and watch to make sure they continue to control costs and use any excess cash flow prudently.



A historical look at Diversified Restaurant Holdings vs. the Travel and Leisure Space and the Consumer Services Group. The stock saw a growth period back in 2013 as they ramped new Bagger Dave's units, falling under pressure as some of those units didn't see the types of volume and comps they had hoped for. A large acquisition (for the company's size) back in 2015 added a decent amount of debt and risk to the company and the stock. A poor overall restaurant environment coupled with commodity and wage pressure led to rough stock results in 2016, with the stock only recently beginning to be noticed again as the new management team focuses on cost control and debt paydown. Further debt reduction over time and a return to normalized restaurant margins could lead to significant gains from here.



Long-term/Five year chart of Diversified Restaurant Holdings. 2015=major acquisition/leverage brought on, 2016=eventual spin-off of Bagger Dave's, company becomes pure play BWW franchisee, 2017 management deals with wage and commodity pressures, methodically paying off debt, stock begins to get noticed again.



Above, 2015-2017 SAUC chart, stock saw lows in the \$1 range back at the end of 2016, only to rebound in 2017.

Below, a look at the recent past six months. We are definitely at the time of the year to see additional potential pressure from tax loss selling.



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