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J. Alexander's Holdings, Inc.

Year-End Conference Call

March 8, 2018

CORPORATE PARTICIPANTS

Tom Lawrence, *DVL Seigenthaler, Moderator*

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Mark A. Parkey, *Vice President and Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Will Slabaugh, *Stephens, Inc.*

PRESENTATION

Operator:

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the J. Alexander's Holdings, Incorporated Fourth Quarter 2017 Earnings Conference Call. Today's conference call is being recorded. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session and instructions will be provided at that time for you to queue up for questions.

It is now my pleasure to turn the conference over to Mr. Tom Lawrence for an introduction of today's speakers. Please go ahead, Mr. Lawrence.

Tom Lawrence:

Thank you. We appreciate your interest in joining us on this conference call to discuss results of J. Alexander's Holdings, Inc. for the fourth quarter of 2017. By now, everyone should have received a copy of the news release that was distributed yesterday afternoon. If anyone does need a copy, it is available on J. Alexander's website at www.investor.jalexandersholdings.com, or you can call Katherine Berendt at 615-244-1818 and she will send you a copy immediately.

Before I turn the call over to Lonnie J. Stout, II, President and CEO of J. Alexander's Holdings, Inc., I'll remind you that all statements made in the news release and during this conference call, other than statements of historical fact, are forward-looking statements. These statements are made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. The Company believes that its expectations are based on reasonable assumptions. However, these forward-looking statements involve known and unknown risks, uncertainties, and other important factors that could cause the Company's actual results, performance or achievements, or industry results to differ materially from the Company's expectations of future results, performance or achievements expressed or implied by these forward-looking statements.

Additional information concerning those risks, uncertainties, and other factors is described under the heading Forward-Looking Statements in yesterday's press release and in Risk Factors and other sections of the Company's Annual Report Form 10-K for the year ended January 1, 2017, filed with the SEC, which you can find on the SEC's website and the Investor Relations section of the Company's website and subsequent filings.

For non-GAAP measures disclosed in this call or related GAAP measures and other information are available in the financial and statistical summary accompanying the press release dated March 7, 2018. In addition, the Company's past results of operations do not necessarily indicate its future results.

Finally, we wanted to let people know that the information statements made during the call are made as of the date of the call, March 8, 2018. Those listening to any replay should understand that the passage of time by itself will diminish the quality of the statements. Also, the contents of the call are the property of the Company and a replay or transmission of the call may be done only with the consent of J. Alexander's Holdings, Inc.

Now it's my pleasure to turn the call over to Lonnie Stout for his opening remarks.

Lonnie J. Stout, II:

Thank you, Tom. Glad to have all of you on the call today. After my remarks I'll turn it over to Mark Parkey to do a financial review. Then we'll take some questions and just back up for a summary.

As you read in our press release yesterday afternoon, J. Alexander's Holdings delivered another quarter of solid same-store sales increases in both restaurant concepts. While we were generally pleased with our overall operating results, we believe we could have turned in stronger performance if we had not been impacted by considerable cost of sales pressure primarily related to higher-than-anticipated beef cost during that most recent fourth quarter.

Also impacting our results in the most recent quarter were some nonrecurring transaction and integration expenses related to our proposed acquisition of the 99 Restaurant & Pub concept, along with a favorable valuation of our profit interest grant with Black Knight's Advisory Services.

I'll provide more detail on nonrecurring expenses associated with the proposed 99 acquisition in a few moments while Mark will discuss details of our profit interest grant during his comments.

For the fourth quarter of 2017, net sales of J. Alexander's Holdings increased 7% to $61,338,000 from $57,323,000 in the fourth quarter of 2016. For J. Alexander's Grill restaurants, our average weekly same-store sales per restaurant advanced 2.3% from $114,600 in the fourth quarter of '16 to $117,200 in the most recent quarter. Total average weekly sales per restaurant rose 2.4% from $112,800 to $115,500 in the final quarter of 2017.

For Stoney River Steakhouse and Grill restaurants, average weekly same-store sales per restaurant rose 7.3% from $79,300 in the fourth quarter of 2016 to $85,100 in the final quarter of 2017. Total average weekly restaurant sales per restaurant improved 5.2% from $79,300 in the fourth quarter of '16 to $83,400 in the final quarter of '17. The most recent fourth quarter performance in same-store sales at Stoney River was one of our best and we are very pleased with those results.

In our development program, we continued construction on two new restaurants previously announced. The first of these will open in King of Prussia, Pennsylvania near Philadelphia sometime in the second quarter. We're excited about the potential of this restaurant. We are also looking forward to opening our other restaurant in 2018, a Stoney River in Troy, Michigan. We have targeted the fourth quarter of 2018 for the opening of this restaurant.

Probably the largest operational issue that confronted us in the last quarter of 2017 was the pressure I mentioned earlier on food cost in both of our concepts, with cost of sales running 32.1% of net sales compared to 30.7% of net sales in the final quarter of '16. While we planned for cost of sales to increase on a comparable basis, we did not anticipate the level of increase that we incurred. Beef costs, for example, were up an estimated 5.9% at our J. Alexander's Grill locations and an estimated 6.9% increase at our Stoney River restaurants. In the final quarter of '16, we experienced an abnormally favorable period for beef cost, with prices decreasing approximately 9% to 10% from the final quarter of '15. Thus, when I said we were generally pleased with overall results for the fourth quarter of '17, I referenced the aspects of our operation over which we had control. We were certainly disappointed in the beef market during the last quarter of 2017.

Income from continuing operations before income taxes was $4,340,000 for the fourth quarter of '17 compared to income from continuing operations before income taxes of $3,676,000 for the same quarter of '16. As noted, there were several factors impacting results for the fourth quarter of 2017, including nonrecurring transaction and integration expenses related to the Company's proposed acquisition of the 99 Restaurant & Pub concept of $1,094,000. Excluding these expenses, income from continuing operations before income taxes would have totaled $5,434,000 for the fourth quarter of 2017. Net income for the fourth quarter of 2017 reached $5,340,000, up 96.3% from the net income of $2,721,000 achieved in the comparable quarter a year earlier. Results included an income tax benefit of $1,105,000 in the final quarter of 2017 compared to an income tax provision of $852,000 in the fourth quarter of 2016.

Our basic earnings per share for the most recent quarter totaled $0.36 compared to $0.19 reported in the fourth quarter of 2016. Diluted earnings per share for the last quarter of 2017 also totaled $0.36 compared to $0.18 in the fourth quarter of 2016.

Adjusted EBITDA for the final quarter of 2017 was $8,177,000 compared to $8,256,000 in the fourth quarter of the previous year. Considering the cost of sales impact in the final 13 weeks of 2017, we considered our performance on the Adjusted EBITDA line to be acceptable.

In summary, we posted another positive quarter at the top line level in the last three months of 2017. We continue to focus on operational execution and have emerged from the last quarter with good momentum as we head into the first quarter of 2018.

I will come back with closing comments on the first quarter of 2018 in a few moments. I now turn the call over to Mark Parkey, our Executive Vice President and Chief Financial Officer, to discuss more details about the fourth quarter and to share our guidance for 2018. Mark?

Mark A. Parkey:

Thanks, Lonnie, and good morning, everyone. As Lonnie indicated, were generally pleased with our results for the final quarter of 2017 despite being confronted with cost of sales pressure primarily related to higher beef costs, as well as a spike in input costs associated with the jumbo lump crab meat. Our same-store sales continued to increase in all restaurant concepts, bolstered by a strong holiday season. In addition to cost of sales pressure there were several other factors impacting results for the fourth quarter of 2017, including the aforementioned nonrecurring transaction and integration expenses associated with the proposed acquisition of 99 Restaurant & Pub. Other factors were the non-cash impact of the Black Knight profits interest valuation and the impact of preopening expense which totaled $104,000 for the fourth quarter of 2017 compared to $836,000 in the fourth quarter of 2016, which represented a favorable impact of $732,000 related to the timing of our new restaurant openings.

During the fourth quarter of 2017, the valuation of the Black Knight Advisory Services profits interest grant resulted in profits interest income of $773,000. This compares to profits interest expense of $881,000 recorded in the fourth quarter of 2016. The Black Knight profits interest grant, which was issued in October of 2015, requires a quarterly valuation. The non-cash expense or income associated with this grant is required to be recognized over the three-year vesting period of the grant and is calculated each quarter based upon the most recent valuation performed using the Black-Scholes valuation model. Any accumulative change associated with the most recent valuation impacts the most recent quarter. Primarily due to the $9.70 per share closing price of the Company's common stock at the end of the most recent quarter, the grant's valuation decreased from $6,650,000 at October 1, 2017 to $4,876,000 at December 31, 2017.

For the last quarter of 2017, our restaurant labor and related costs as a percentage of net sales were 29.5% compared to 29.7% of net sales in the fourth quarter of 2016. Other operating expenses were 19.4% of net sales in the fourth quarter of 2017 compared to 19.1% of net sales in the last quarter of 2016. The Company's consolidated operating income for the final quarter of 2017 was $4,507,000 compared to consolidated operating income of $3,794,000 recorded in the corresponding quarter of 2016.

With respect to average guest checks, which include alcoholic beverage sales, the average guest check within the J. Alexander's Grill collection same-store base of restaurants during the fourth quarter of 2017 increased by 2.7% to $31.86 from $31.03 during the same quarter of 2016. The average guest check within the same-store base at Stoney River restaurants during the last quarter of 2017 decreased 1.3% to $44.32 from $44.90 in the comparable quarter of 2016. Same-store guest count at the J. Alexander's Grill restaurants in the fourth quarter of 2017 declined by 0.3% relative to the corresponding quarter of 2016, and increased 8.7% at the Stoney River restaurants compared to the fourth quarter of 2016.

The effective menu pricing for the fourth quarter of 2017 was estimated to be an increase of 1.6% for the J. Alexander's Grill restaurants and 0.8% increase for the Stoney River restaurants compared to the same quarter of 2016. Inflation and food costs for the fourth quarter of 2017 was estimated to total 4.9% for the J. Alexander's Grill restaurants. At our Stoney River restaurants inflation for the fourth quarter of 2017 was estimated to total 5.9%. As Lonnie pointed out, beef prices at both our J. Alexander's Grills and Stoney River concepts were sharply higher than expected in the final quarter of 2017.

The Company's restaurant operating margin as a percentage of net sales was 14.9% in the fourth quarter of 2017 compared to 16.6% for the final quarter of 2016. Consolidated general and administrative expenses were 5.6% of net sales in the fourth quarter of 2017 compared to 8.5% of net sales in the fourth quarter of 2016. As previously disclosed, the non-cash impact of the Black Knight profits interest grant is included in general and administrative expenses and had a significantly favorable impact on this line item during the fourth quarter of 2017.

During the fourth quarter of 2015, the Company's Board of Directors authorized a share repurchase program for up to 1.5 million shares of the Company's common stock over a period of three years ending October 29, 2018. No shares were repurchased by the Company during 2017.

Finally, Lonnie referenced the tax benefit that the Company recorded during the fourth quarter of 2017 totaling $1,105,000 compared to an income tax provision of $852,000 relative to the fourth quarter of 2016. For the year, the Company recorded a tax benefit of $1,347,000 compared to an income tax provision of $2,062,000 during fiscal 2016. The 2017 benefit reflects the impact of the Tax Cuts and Jobs Act which was signed into law on December 22, 2017 and resulted in a reduction of the U.S. corporate tax income rate from 35% to 21% for tax years beginning after December 31, 2017.

In connection with this legislation, we recorded a net tax benefit of $1,345,000 in the fourth quarter of 2017 related to the revaluation of the Company's deferred tax assets and liabilities, and anticipate that our effective annual tax rate will be reduced from a rate of 22% to 23% to a range of 10% to 16% beginning in fiscal 2018.

The following performance outlook is based on current information as of March 7, 2018. The Company does not expect to update the guidance provided as follows before the next quarterly earnings release. However, the information on which the outlook is based is subject to change and the Company may update its full business outlook or any portion thereof at any time for any reason.

Based upon current information, the guidance for the 2018 fiscal year is as follows: for the J. Alexander's Grill restaurants, an increase in same-store sales ranging from 2% to 3%; for the Stoney River Steakhouse and Grill restaurants, an increase in same-store sales ranging from 3.5% to 4.5%; capital expenditures ranging from $18 million to $20 million; total revenue ranging from $245 million to $247 million; net income ranging from $7.7 million to $8.7 million; Adjusted EBITDA ranging from $26.6 million to $27.6 million; and as mentioned previously, the effective tax rate is estimated at 10% to 16%; finally, basic earnings per basic range from $0.53 per share to $0.60 per share. I'll also note that the 2018 outlook anticipates an additional $835,000 in transaction expenses related to the proposed 99 Restaurant & Pub acquisition that were incurred subsequent to the end of Fiscal 2017.

I will now turn the call back to the Operator to open the participant calling segment for this morning's call.

Operator:

Thank you. To ask a question today please press star, one on your telephone keypad and a confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Thank you. Our first question today comes from the line of Will Slabaugh with Stephens. Please go ahead with your question.

Will Slabaugh:

Yes. Thanks, guys, and congrats on the quarter. I wanted to ask first about the uptick you saw at Stoney River with the big numbers you posted there. What were the primary benefits that you saw in the quarter versus what you maybe had seen in the past, and if there was anything geographical to call out or anything else that may have contributed to that big number?

Lonnie J. Stout, II:

Will, there's several factors. One, the Germantown restaurant that we designed after we acquired Stoney River has finally reached maturity, and as with many of our restaurants, once they get in a mature state, they seem to generate significant same-store sales gains, so that restaurant is performing exceptionally well. We've also, after we acquired Stoney River in 2013, we had three mall locations and we worked really hard on putting together a lunch program for those locations, and they are really performing exceptionally well with lunch. We've also added lunch to another restaurant and the performance is strong. Our regular business is growing at Stoney River. We've done a lot of work over the last two or three years of the menu and we really are pleased with where the quality is.

In terms of geographic drive, oddly enough, the only market that sort of was disappointing to us in Stoney River last year was Atlanta. Except for the restaurant located in Cumberland Mall, where we have a strong lunch program, the two original Stoneys were a little slower than we anticipated. But we didn't observe any big geographic issues. I think I mentioned on a call a year or so ago the national market was under tremendous pressure. You can read about it in any publication the number of openings here. We've had a lot of trial. But our restaurant out of CoolSprings had sort of a two-year dip, but it's starting to build up; and our restaurant in Nashville, same thing, it's starting to build back up. Overall, good performance at Stoney River, the programs we've had have been very accepted, strong lunch business. We are going to move totally to a lunch and dinner model in the future. We did do one restaurant this last year that was dinner-only. It's doing very well, but we think the capital cost differential is so small we're better off doing lunch and dinner. The only difference it makes us find the sites a little bit harder because we can't cannibalize the bank next door as parking. But we think that that is definitely how to maximize value at Stoney River.

Will Slabaugh:

Got it. I also wanted to ask about quarter-to-date trends that you mentioned in the press release. It sounds like weather weighed pretty heavily in the past couple of months as it did for a lot of concepts. But if we were to focus on the underlying momentum and maybe kind of look at markets that didn't have the weather, can you talk about that a little bit more and how you feel about the moment of both concepts on a go-forward basis?

Lonnie J. Stout, II:

Yes. Overall we feel good about moment. We did take a real big hit on weather. We had some bad weather in Michigan, which is one of our strongest markets, but when the snow went away the sales popped right back up to good same-store sales trends. We got hit in the mid-South, which always destroys us—the Memphis, Nashville markets, Atlanta got some bad weather which is very rare. But these markets have all bounced back. Our West-End restaurant here in Nashville is one of stronger same-store sales performers in the quarter. We don't really see any geographic sales issues except some sale softness in the Atlanta market for Stoney and J. Alexander's is continuing. Those restaurants are sort of up a point one week and down two points the next week. Fortunately, our exposure is not that great with the exception of the Cumberland Mall restaurant where the lunch program continues to grow and grow and grow. That restaurant is usually in the top two or three Stoneys.

But on a national basis, we see good sales in Michigan; Ohio is pretty stable. Most of the other markets—Florida—all of our restaurants have been up in the first quarter except for one. That's pretty normal when we get competition and different things from time to time. So, our outlook for both operating groups minus the weather, I would say is very strong.

Will Slabaugh:

Great. Lastly, just a follow-up on the beef commentary that you made; can you talk a little bit more about the dislocation that you saw in the fourth quarter and what led to that? We've heard a lot about, kind of ribeyes rising a lot, and then some other kind of movement that the USDA made, but I'm curious also what you've seen since the year ended and what that makes you think about what we're seeing in 1Q, and then as we work (phon) into 2018.

Lonnie J. Stout, II:

Sure. Well, I think the best way to explain the beef, Will, is to go back to the beginning of last year. Our forecast and our suppliers that we get forecast data from said they expected beef costs to be pretty moderate for the first nine months of the year. They did expect a spike in the fourth quarter, but not a significant spike. Again, we knew we were going to compare to some really, really favorable numbers. The spike we saw in the fourth quarter was, I'm going to say, 10% higher than we had anticipated it was going to be. (Inaudible) cattle are big and we like to buy small ribeyes and it was really hard to find them. There were quality issues and substitution issues. Ribeye accounts for a significant part of our beef at J. Alexander's. Stoney River is more of a fillet tenderloin sort of market. But even tenderloins were under some pressure.

Our theory was the Chinese market coming back on had some impact on this. All the beef producers deny that. They say China had no impact on beef prices. I just don't know how many hungry millions of people in China buying U.S. beef could not have an impact. But if you Cardale (phon) or any of the big producers, they'll say that that's not accurate, but I'd still suspect that.

But prices did drop immediately after the holidays and have now dropped by significant margins. We're very happy with the level of beef pricing right now with one exception, the first quarter last year was very, very favorable. Even though we're much more favorable to the fourth quarter, we're still running pretty high compared to last year, but well within our normal range and guidelines. Abundance of quality beef up there in the market, so we're not having to pay premiums to get our spec, so our beef outlook is good. But that was a confident shaker in the fourth quarter because we didn't know it was coming and all of the suppliers that we work with around the country said the same thing: that they were in shock too. Really, Will, we've not heard any good explanation. I gave you mine, but no one agrees with me.

Will Slabaugh:

Got it. Thanks, Lonnie.

Lonnie J. Stout, II:

All right. Thank you.

Operator:

As a reminder, you may press star, one to ask a question. Thank you. At this time I'll turn the floor back to Lonnie Stout for closing remarks.

Lonnie J. Stout, II:

Thank you so much and thank all of you for being on the call. The year 2017 was indeed an eventful one for J. Alexander's Holdings. Included was the announcement of our proposed acquisition of 99 Restaurant & Pub. While we were disappointed that the proposed merger was not approved by the disinterested shareholders, we were very appreciative of the level of participation and support we got from many shareholders. We reached out and contacted our 31 largest shareholders representing 76% of the stock. We also reached out to retail investors. We obtained a lot of feedback that we've shared with our Board about many items, corporate governance among them, and the Board has been very receptive to hearing that and to discussing some of the shareholder concerns we received.

We've started the new year with considerable momentum, voided by a strong holiday season at the end of 2017. Our gift card sales were very encouraging in our restaurant concepts and that usually bodes well for the future. One issue we encountered, as we noted, was the harsh winter weather we had in early parts of first quarter, and especially in our Midwestern markets and some of our Southern markets through Valentine's Day. We found it necessary to close our restaurants for a total of 24 days, representing loss revenue of about $370,000 during the first six weeks of the quarter. A year ago in the same period we were closed for a total of two days, which accounted for revenue loss of about $33,000.

Our Leadership remains focused on making sure that our newer restaurants are operating well, tracking towards expected levels of profitability. Every new location that we launch has a separate set of challenges to overcome, from construction to post-opening periods. Today we're pleased with the progress that we've made in our newer locations. As mentioned earlier, we are optimistic that they will continue to ramp up as planned. Beef prices are relatively stable compared to historical trends as we move forward in the first quarter of 2018. We anticipate that we should be able to hold the line relative to cost for sales during 2018.

In summary, we're confident that the year ahead will be a positive one for J. Alexander's Holdings. We anticipate continued success in all of our restaurants, and as I noted in yesterday's press release, we will remain sharply focused on building our restaurant business organically and strengthening our competitive position through the delivery of outstanding food and professional service.

I'd like to turn the call back over to our Operator. Thank you.

Operator:

This does conclude today's conference call. At this time you may disconnect. Thank you.