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J. Alexander's Holdings, Inc.

Second Quarter Earnings Conference Call

August 10, 2017

CORPORATE PARTICIPANTS

Tom Lawrence, *DVL Seigenthaler, Moderator*

Lonnie J. Stout, II, *Chairman, President and Chief Executive Officer*

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 Second 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 second quarter of 2017. By now, everyone should have received a copy of the news release that was distributed yesterday, Thursday, August 10. 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 Forward-Looking Statements, Risk Factors and other sections of the Company's Annual Report Form 10-K, for the year ended January 1, 2017, and subsequent filings with the SEC, which you can find on the SEC's website and the Investor Relations section of the Company's website.

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 August 10, 2017. 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, August 11, 2017. 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.

It is now my pleasure to turn the call over to Lonnie Stout for his opening remarks.

Lonnie J. Stout, II:

Thank you, Tom. I want to welcome everyone listening to the call today. I'm here, as well as Mark Parkey, Executive Vice President and our Chief Financial Officer.

We were generally pleased with our results for the second quarter ended July 2, 2017. Same-store sales and guest counts improved in all of our restaurant groups. We continue to be encouraged with the progress of our newer J. Alexander's and Stoney River restaurants. It was a good quarter in virtually all areas. The one primary concern was and continues to be our cost of sales, which was severely pressured by an upward spike in beef prices during the second quarter. We estimate that beef prices were up 5.1% and our JAX Grills restaurants and up 6.9% in our Stoney River restaurants.

Also putting a strain on our cost of sales in the second quarter were higher produce prices, which we incurred during the first month of the quarter, but has since normalized.

Our cost of sales as a percentage of net sales in the second quarter amounted to 33% as compared to 32.2% in the comparable quarter of 2016. Net sales of the J. Alexander's Holdings in the most recent quarter of 2017 increased 8% to $58,216,000, up from $53,921,000 in the second quarter of 2016. For the JAX Grills restaurants, our average weekly sales per restaurant rose 4.4% to $114,000 a week, from our weekly average of $109,200 posted in the second quarter of 2016. This improvement came at a time when many in our industry have experienced top line difficulties, a trend that we do not take lightly.

For the Stoney River Steakhouse and Grill restaurants, average weekly same-store sales in the second quarter of 2017 reaped $70,400, up 2.5% from the $68,700 recorded in the comparable quarter a year ago. Total sales within the Stoney River group were somewhat softer than anticipated, but still acceptable. As previously mentioned, we've had new competition in the greater national markets since 2016 and we've experienced some choppy sales in the Atlanta market in the past quarter.

Stoney River has a much smaller store base, and when the individual restaurants have issues, it tends to affect the entire group. We continue in our belief that we don't have any systematic issues in our Stoney River concept, and as the beef market stabilizes, we anticipate that Stoney River will resume the favorable trajectory it had been tracking.

The average weekly guest counts within the same-store sales base of our JAX Grills collection advanced 1% for the quarter of 2017 as compared to the corresponding quarter of 2016. Guest counts within the same-store sales base at Stoney River were up 4.5% for the second quarter of 2017 compared to the second quarter of 2016.

Income from continuing operations before income taxes in the second quarter of 2017 decreased to $42,000 from $1,684,000 achieved in the corresponding quarter a year ago. This significant decrease was primarily due to the impact of the quarterly valuation of the process interest grant issued in October 2015 to Black Knight Advisory Services, LLC. For the most recent quarter, non-cash Black Knight profit interest expense was $1,714,000. This was an increase of $1,396,000 from the $318,000 reported in the second quarter of 2016. Also during the second quarter of 2017 we incurred consulting fees of $174,000 from our consulting agreement with Black Knight, which compared to $158,000 in the second quarter of 2016.

Finally, in the second quarter of 2017, results reflect transaction and integration expenses of $460,000 related to our recently announced planned acquisition of the Ninety Nine Restaurant and Pub concept from Fidelity Newport Holdings, LLC and Fidelity National Financial Ventures, LLC. Thus, between the increased non-cash expense associated with the Black Knight profit interest grant valuation and the increase noted (phon) relative to the transaction costs, we incurred a decrease in income from continuing operations before income taxes of $1,841,000 during the second quarter of 2017 compared to the second quarter of 2016.

Net income for the second quarter of 2017 was $186,000, a decrease of $901,000 from the net income of $1.087 million reported in the second quarter of 2016. This decrease is largely attributable to the same factors discussed above relative to income from continuing operations before income taxes.

Basic and diluted earnings per share totaled a penny for the second quarter compared to $0.07 for the corresponding quarter of 2016. Our restaurant operating profit margin was 12.1% for the second quarter of 2017 as compared to 12.4% in the second quarter of 2016. Our consolidated operating income totaled $215,000 in the most recent quarter compared to $1,822,000 posted in the corresponding quarter a year ago. The estimated annual effective tax rate for discrete items was a six month's period ended July 2, 2017 and July 3, 2016 was 20.2% and 22.8% respectively, resulting in a benefit of $254,000 during the second quarter of 2017 compared to a provision for income taxes of $486,000 in the second quarter of 2016.

Finally, Adjusted EBITDA in the second quarter of 2017 was $5,465,000, a gain of 11%, or $543,000, from $4,922,000 reported in the second quarter of 2016.

Turning to our Development program, we've announced plans in the most recent quarter to begin construction in the third quarter on a new J. Alexander's restaurant and a new Stoney River restaurant. As disclosed, the new J. Alexander's location will be our first in Pennsylvania and will be situated in King of Prussia, about 15 miles outside of Philadelphia. The new Stoney River Steakhouse and Grill will be in Troy, Michigan, which is a market we know very well. Both of these restaurants are targeted for openings in 2018.

For the remainder of the year, we will continue to aggressively seek opportunities to develop both J. Alexander's and Stoney River restaurants. We've been pursuing potential opportunities for J. Alexander's in Texas and in Florida where we have multiple locations, and now that we're going into Philadelphia, we'll be looking at additional J. Alexander's opportunities in the Pennsylvania and New Jersey corridor. We hope to have new leases to announce by the end of the year for additional restaurants opening in 2018.

I will come back with further comments shortly. I anticipate that several of you may have questions related to our recent announcement related to the proposed merger with Ninety Nine Restaurants, which we will be happy to discuss during the question-and-answer session. I would also note that we posted some information in Q&A format to our website yesterday, which we filed on Schedule 14A with the Securities and Exchange Commission related to the proposed merger, and we anticipate this information will be helpful as you evaluate the proposed transaction.

I would now like to turn the call over to Mark Parkey, our Chief Financial Officer, to discuss more details on the second quarter and to update our guidance for the current year. Mark?

Mark A. Parkey:

Thank you, Lonnie, and good morning, everyone. As Lonnie expressed, we were pleased with our operating performance in the second quarter of 2017. Our results were achieved despite difficult industry conditions, as evidenced by the impact of sharply escalating beef costs on our cost of sales, and while we did get back some of the ground gained earlier in the year, we consider the first half of 2017 to be successful by most metrics. In a few moments I'll provide an update on guidance for the year, but before that, let's look at several other key financial indicators for the most recent quarter.

As Lonnie mentioned, we experienced higher average weekly same-store sales and guest counts in all of our restaurant concepts during the second quarter. 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 second quarter of 2017 totaled $30.80, a gain of 3.4% from $29.80 during the second quarter the prior year. The average guest check within the same-store base of Stoney River Steakhouse and Grill restaurants totaled $44.10, a 2.0% decrease from $44.99 during the second quarter of 2016.

On a consolidated basis, average weekly guest counts within the Company's J. Alexander's Grill and Stoney River Steakhouse and Grill locations rose 1.0% and 2.5% respectively for the second quarter of 2017, as compared to the corresponding quarter of 2016. Average guest checks for the combined J. Alexander's Grill collection advanced 3.3% to $30.85 in the second quarter of 2017 as compared to $29.86 in the comparable quarter of 2016, while the average guest checks for the Stoney River Steakhouse and Grill restaurants decreased 2.2% to $42.17 in the second quarter of 2017 from $43.13 in the same quarter a year ago.

The effective menu pricing for the second quarter of 2017 was estimated to be an increase of 2.3% for the J. Alexander's Redlands Grill restaurants and a four tenth of a decrease for the Stoney River Steakhouse and Grill restaurants compared to the same quarter of 2016. Inflation and food costs for the second quarter of 2017 was estimated to total 3.5% for the J. Alexander's Grill restaurants, with beef cost increasing by 5.1% compared to the second quarter of 2016. For the Stoney River Steakhouse and Grill restaurants, inflation for the second quarter of 2017 was approximately 4.4%, with beef costs up approximately 6.9%.

The Company's restaurant operating margins as a percentage of net sales were 12.1% in the second quarter of 2017 as compared to 12.4% in the second quarter of 2016. Restaurant labor and related costs as a percent of net sales were 30.8%, which is consistent with the second quarter of the previous year. Other restaurant operating expenses were 19.8% of net sales during the second quarter of 2017 as compared to 20.5% of net sales in the corresponding quarter of 2016.

Consolidated general and administrative expenses, which include the Black Knight profits interest previously discussed, were 10.9% of net sales in the second quarter of 2017 compared to 8.8% of net sales in the same quarter of the prior year. By way of reminder, since inception in 2015, the fair value of the Black Knight profits interest grant has been recalculated on a quarterly basis. Any change in the estimated fair value of the grant has been reported at the end of each quarter in a manner which brings accumulative expense recognized growth to the grant current with the latest valuation.

The original vesting period associated with this profits interest grant was three years, but as noted in yesterday's Q&A that was addressed by Lonnie previously, if our proposed merger with Ninety Nine Restaurants is completed, as anticipated during the fourth quarter of 2017, the Black Knight consulting agreement will be terminated and the profits interest grant will become fully vested at that time. Black Knight will have 90 days in which to exercise the exchange of their rights under the profits interest grant into Class A Common Shares of J. Alexander's Holdings, Inc. Subsequent to such an election over the expiration of the 90-day period, the Company will no longer be required to perform a quarterly valuation relative to this grant.

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 have been repurchased by the Company during Fiscal 2017.

Based upon current information and as noted in yesterday's release, the Company views its business prospects for the remainder of 2017 as favorable and, therefore, is updating certain items of its previously released guidance for 2017 and is disclosed in the Company's release dated March 2, 2017. This update is as follows: For same-store sales, our prior guidance range for the J. Alexander's Grills restaurants was an annual increase of 1.5% to 2.5% over 2016. The updated guidance for 2017 anticipates an increase of 2.5% to 3.5%. Our prior guidance range for same-store sales of the Stoney River Steakhouse and Grill restaurants was an annual increase of 1.5% to 2.5% over 2016 whereas the updated guidance for 2017 anticipates an increase of 1.0% to 2.0% for the year.

With respect to consolidated revenue for Fiscal 2017, our prior guidance range was $232 million to $234 million whereas our updated guidance anticipates a range of $233 million to $235 million. The Company's Adjusted EBITDA guidance range for full-year 2017 included in the March 2, 2017 release is unchanged as is the Company's guidance range included in the May 2, 2017 release relative to capital expenditures for Fiscal 2017. As a result of the Company's planned acquisition of Ninety Nine Restaurants previously discussed and the uncertainty of transaction costs and changes to the Company's financial statements that may result from the transaction, the Company is not presenting other items of guidance, and previous disclosures of those items should not be relied upon.

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

Operator:

Thank you. At this time we'll be conducting a question-and-answer session. If you would like to ask a question, please press star, one, from your telephone keypad and a confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants that are 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 is from the line of Will Slabaugh with Stephens. Please go ahead with your question.

Will Slabaugh:

Yes. Thank you. I want to ask you first on general trends. Lonnie, you mentioned some of what's been going on out there in the industry and it seems like we've heard a lot of companies talk about increasing softness as the quarter went along, and then even further into July. It seems you've held up much better, so could you talk about what you've seen most recently in your businesses versus those trends you mentioned, and if you've noticed any difference in guest behavior, weekday, or weekend trends or anything else you may think is notable?

Lonnie J. Stout, II:

Will, we've obviously had very good performance across all of our groups in the second quarter. It's sort of difficult to get a feel around the summer, this quarter starting in July, August, September run. July is always soft relative to the other months, but our trends are holding up. We saw earlier in the second quarter a little bit of weakness in some of the weekend numbers, but we had strong through the week sales, and then towards the end of the second quarter, our weekend sales were good as well. Our

Sundays, which is a good indicator of same-store sales growth, have been very strong, and we've been very pleased with that. So, yes, there is some weakness around the industry for sure.

Again, what I think sets us apart a little bit is that we're much more of a destination restaurant than a lot of casual dining restaurants, and the upscale nature of our business, we think sort of gives us a little protection from general industry trends.

A second thing that I'll talk that makes us a little different is though we have restaurants in mall areas, we only have one mall restaurant, and its performance was very good during the second quarter. Our mall area restaurants have other generators besides the mall, so even though we have some restaurants on mall pads, we think the retail trends being reported by other retailers certainly are having some serious impact on restaurants, so, just, our locations somewhat protect us from some of the things going on with the change in the retail makeup of the marketplace and the impact it's had as consumers seem to be shifting their preferences from in-store shopping, at places like Macy's, to more online shopping.

Will Slabaugh:

Makes sense. Then also in your comments on cost of sales, just wanted the update of what you've been seeing most recently there with beef and any of the other commodities that may be moving the basket around.

Lonnie J. Stout, II:

Sure. We saw a very much unanticipated spike in beef during the second quarter, and this followed meetings with our key purveyors and suppliers back in December and January which were forecasting major declines throughout the year. I can only offer a theory. When China came online, I think that put additional pressure on beef. I think it will put some more pressure on beef.

The other thing, you never know what the retailers, the grocery stores, are planning to do in their summer beef promotions. Two years ago they went long on strip loins and light—and almost destroyed the strip loin market. This year they decided to promote ribeyes. That's the number one item that we purchase are ribeyes, and ribeye prices shot up to the highest level we've seen in many years, so it had a tremendous impact on our cost of sales.

At the same time, as soon as the mid-summer season started to end, those prices started to decline. In August right now, prices are abnormally low, or as low as they were last year for ribeyes. If that continues, then our beef input costs will get right back online. Subject to the wildcard is how much is going to be sold to China and will the U.S. purveyors disclose what's going on with the Chinese beef relationship.

But, in summary, we feel much better about the trends, but we're not willing to declare victory at this time.

Will Slabaugh:

Makes sense. Okay. Then the last thing I had was on the Ninety Nine acquisition, and looking at the Exhibit 1 you've laid out in your Q&A on your website. As I walk through the, I guess, assumed accretion should you have had Ninety Nine last year and looking at the $0.70 versus $0.47. On the $0.23 of incremental ascribed value to Ninety Nine, I know there are a lot of moving pieces to get there, so I guess I'm wondering, more broadly, are there one-time pieces or pieces that should be added or removed, or should we think about Ninety Nine going forward as sort of building off of that roughly $0.23 base of incremental earnings power to J. Alexander's?

Lonnie J. Stout, II:

Well, we didn't really put any magic in the table. We eliminated the Black Knight from the numbers last year. Then we estimated a tax provision had Ninety Nine been part of J. Alexander's. We didn't really build-in, Will, anything other than that. Mark, is there anything you want to comment on about the table?

Mark A. Parkey:

Yes. I think that pretty well sums it up. I mean, if you look at the Exhibit 1 that you referenced, Will, the components are pretty well laid out there. We have not baked in any specific synergies related to the transaction at this point, so this is all just kind of the known pieces that exist and have been disclosed for the most part, so I think that pretty well summarizes it.

Lonnie J. Stout, II:

Will, I think if you look at that table, I hope you see why we had an interest in the transaction.

Will Slabaugh:

Yes. Financially, it looks like it makes sense. I'm wondering also if you mentioned no synergies are assumed here, and, yet, at least it sounded like on a previous call that it makes sense to bring some of the back office operations that Ninety Nine has under J. Alexander's umbrella, so we should anticipate at least some benefit there going forward; is that fair?

Lonnie J. Stout, II:

Yes. The back office is now, for Ninety Nine, is managed by ABRH. Ninety-Nine has a great staff in Massachusetts and we don't anticipate any changes there. They're very efficient and really operate with fairly low overhead, so we're very pleased with that. We think that we can build a back office using the same systems we use here that will be very efficient and well-managed, so we think that will be a benefit to the folks up in Massachusetts too. We're more restaurant-focused, as you know, than most companies. We're not tops-down. We're very bottom-up, so we put the restaurants first and we think that system is efficient and yields efficient results.

Will Slabaugh:

Got it. Last thing, if I could, so getting into casual dining right now when we're seeing things slow down—I know you put part of this in your document that you published—but it does seem like an interesting time to be entering casual dining as we're seeing some of the softness play out. Wonder if you could comment on your views of casual dining and then Ninety Nine's pace within casual, and then sort of any opportunities you may see to improve the positioning of Ninety Nine going forward and if those opportunities are part of the reason that you wanted to be a part of it.

Lonnie J. Stout, II:

Well, there's several things. My view of casual dining is it's a segment of the industry that's in serious trouble. The quality of casual dining in the $15, $20 check average has consistently gone down. I think what most of the companies have done—I won't name any, but you can imagine—they've tried to maintain their check average at $15, and the only way they've been able to do that is cut labor and cut the quality of their food. If you go back and look at casual dining, say, 20 years ago, they weren't injecting steaks with saline solution or rice wine vinegar, they were selling pretty good choice beef. If you look at the burger mix—I was in the Wendy's business back in the 70s and our hamburger was almost pure ground chuck, and over the years, you take out all the good parts and put bad parts in is how I would describe it, and the quality drops as you think it's so important to maintain check average. The consumer is not that stupid. You know, they figure out that your food just doesn't taste good or doesn't look as good.

Ninety-Nine has been an exception to a lot of this. If you look at their track record, even though casual dining hit the wall a couple of years ago, their same-store sales were up last year and up the year before. I think Charlie Noyes and his Team have been very sensitive to what their guests in that New England market want.

The other thing, you know, we've got to call Ninety Nine a casual dining concept, but it has more regional characteristics than it does broad-based casual dining. If you run an Applebee's or Brinker, or any of the national footprint casual dining restaurant groups, you try to design products that have broad national appeal. Charlie and his Team have been able to focus on the New England market, so you go into one of their restaurants and get lobster roll, you get chowder, you get local New England fish. That really, to me, sets them apart. That's one of the things that attracted us to them.

The final thing is, though, as you've read in reports and I've read and seen in research, every large casual dining group has now admitted they've let their quality decline, and so they're all moving to have a higher-quality menu, and I'm sure over time, as Charlie thinks through what he wants to do with the Ninety Nine menu, we think that we can provide help to him as he moves his quality forward. But Charlie's going to always be sensitive to providing great value to those New England guests.

The other attribute we love about Ninety Nine is tremendous guest loyalty to that brand, and that's a really unique thing, and the Ninety Nine Management Team has fought hard to keep that. I want to be as nice about this as I can, but they were bought by O'Charley's back I think around 2002 or '03 and they've been able to resist many of the bad things that happened with the seven CEOs at O'Charley's. That's why Ninety Nine has sort of survived what's going on in casual dining. They dig their heels in, they fight for their guests, and they fight for their employees, and that's the exact philosophy we have here at J. Alexander's. We think happy employees makes for happy guests, and if you've got happy guests, you can build same-store sales.

Will Slabaugh:

Great. Thanks for the color.

Operator:

Thank you. As a reminder, to ask a question you may press star, one. Thank you. It appears we have no additional questions at this time.

I would like to turn the call back Lonnie Stout for closing remarks.

Lonnie J. Stout, II:

Thank you. On balance, as Mark mentioned, the first half of 2017 was a tale of two quarters, a better-than-expected first quarter basically offset by some challenges in the second quarter. The two positive constants across both quarters: strong momentum at the top line, solid guest traffic. I have noted the single chief concern that we have right now relates to cost of sales in beef. This is a wildcard relative to third quarter performance. We have seen, as I mentioned on the call, some relief in the first several weeks of the quarter and that's encouraging to us, but we remain guarded in our outlook until beef prices do come back to normal levels. If beef prices remain flat with prices in 2016, we think that will be a win based on our experience in the second quarter of '17.

With respect to the Ninety Nine acquisition, we are already working on preparing the proxy statement that will be filed with the Securities and Exchange Commission and sent to all of our Shareholders. We look forward to the opportunity to get more details about this transaction in front of our Shareholder base so that they can evaluate this transaction. The Proxy Statement, when filed, will be sent at no charge and will be available on the Securities and Exchange Commission's website at www.SEC.gov.

Once again, we appreciate your time this morning and your interest in our Company. We look forward to communicating with you during the balance of this year. Thank you.

Operator:

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