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J. Alexander's Holdings, Inc.

Fourth Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

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

Mark Parkey, *Chief Financial Officer*

Tom Lawrence, *Investor Relations*

CONFERENCE CALL PARTICIPANTS

Will Slabaugh, *Stephens*

PRESENTATION

Operator:

Good morning ladies and gentlemen. Thank you for standing by. Welcome to the J. Alexander's Holdings Fourth Quarter 2018 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. 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 introduction of today's speakers. Please go ahead, Mr. Lawrence.

Tom Lawrence:

Thank you, Dana. We appreciate your interest in joining us on this conference call to discuss the results of J. Alexander's Holdings Inc. for the fourth quarter of 2018. 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. Alexanders' 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 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 headings, Forward-Looking Statements in yesterday's press release and in Risk Factors and other sections of the Company's annual report on Form 10-K for the year ended December

31, 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, related GAAP measures and other information are available in the financial and statistical summary accompanying the press release dated March 11, 2019. 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 12, 2019. 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 the replay or transmission of the call may be done only with the consent of J. Alexander's Holdings Inc.

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

Lonnie Stout:

Thank you Tom, and thank you to all of the participants on the call today. Also with me today is Mark Parkey, our Chief Financial Officer, who will have a few comments later.

Generally we're pleased with our overall performance in the fourth quarter of 2018, particularly with the aspects of our operations over which we have control, but we're certainly disappointed in the negative impact some of the unusual adjustments had on our results. The quarter ended on December 30, 2018 and it was challenging on several fronts. Due to the 52-week cycle associated with our fiscal year, 2018 was one of those odd years where we didn't get the benefit of a New Years Eve in our quarter. Given that New Years Eve is historically one of our highest volume days of the year, this situation resulted in approximately $300,000 of revenue within the J. Alexander's Grill group and approximately another $100,000 of revenue in the Stoney River locations being effectively pushed into the first quarter of 2019. In addition, under the new accounting standard associated with gift card breakage adopted at the beginning of 2018, we now recognize the majority of our gift card breakage in the first quarter of our fiscal year instead of the fourth quarter, as we did in prior years. While this situation did not have any significant effect on our full year results, revenue associated with gift card breakage for the fourth quarter of 2018 was $218,000 less than breakage in the fourth quarter of 2017.

For the fourth quarter of 2018, net sales at J. Alexander's Holdings rose 3% to $63,205,000, up from $61,338,000 as reported in the final quarter of 2017. Our average weekly same-store sales in our J. Alexander's Grill locations were $115,800, up 3/10ths of 1% from $115,500 reported in the fourth quarter of 2017. For the Stoney River Steakhouse and Grill restaurant group, average weekly sales per restaurant were $85,400, up 2.4% from the $83,400 recorded in the fourth quarter of 2017.

The softness in top line growth at our J. Alexander's Grill locations was primarily attributed to a handful of restaurants, including some of our newer locations. We've certainly taken an all-hands-on-deck approach to those locations to try to ramp up sales, highlighted by some menu price adjustments we've made and a host of other aggressive social media initiatives. We've also dispatched numerous support staff to assist the local teams to ensure that inside the four walls we're operating efficiently, and we are pleased with our initiatives and they're showing positive results at the restaurants, but we remain—and we also remain confident that our guests, who are beginning to come as regulars, are receiving the kind of experience necessary to build long-term business at these locations. This is not an unusual thing to have slower ramp-up in some of our new restaurants.

Part of the slowdown in same-store sales growth in our J. Alexander's Redlands Grills during the fourth quarter was intentional as we did take some menu price decreases in two locations as we helped build additional traffic in those two locations. We also opted not to take additional price increases during the quarter at our remaining locations, given market conditions and the competitive nature of the segment overall. Expressed another way, we had about an 8/10ths of 1% menu price increase that was implemented in October 2017 and it rolled off for comparative purposes at the beginning of the final quarter of 2018, and we did not replace that with a corresponding price increase. We believe this was the right decision in the current environment and that will have a very positive long-term impact.

Also impacting our performance in the last quarter of 2018 was food cost pressure in both of our restaurant groups. Cost of sales ran 32.7% in the most recent quarter as compared to 32.1% in the final quarter of 2017. The impact of the 60 basis point increase for the fourth quarter of 2018 was predominantly related to input costs associated with beef, produce and poultry. Beef was up an estimated 4.1% in our J. Alexander's Grill locations and up 5.7% at Stoney River. In addition, the national recall related to romaine lettuce in November drove the cost of varieties of other lettuce higher, and that was the largest component of the produce increase incurred during the quarter.

We also lost five days of revenue during the fourth quarter from restaurant closings due to severe weather conditions, whereas we had no closures in the fourth quarter of 2017. Four of the five lost revenue days occurred in our North Carolina market due to a hurricane, and restaurants affected included our J. Alexander's in Raleigh and our Stoney River in Chapel Hill.

On November 30, 2018, we announced the termination of the consulting agreement with Black Knight Advisory Services LLC, which had been entered into in September of 2015 in connection with our separation from Fidelity National Financial Inc. Pursuant to the provisions of this agreement, the termination required a cash payment by J. Alexander's Holdings of approximately $4,560,000 to Black Knight. The Company funded this obligation on January 31, 2019 through the use of cash on hand. This payment eliminated the obligation to pay Black Knight 3% of the Company's Adjusted EBITDA for the remaining 6.8 year term of the consulting agreement. According to the provisions of the termination agreement, J. Alexander's Holdings is also required to make a separate cash payment to Black Knight of $705,000 for the pro rata portion of the 2018 consulting fee within 10 days of the completion of the Company's 2018 audit. Mark Parkey will provide further details of our termination agreement with Black Knight during his comments in a few moments.

The final valuation of the Black Knight profit interest grant was calculated at the completion of the vesting period of October 6, 2018 and resulted in a profits interest income of $450,000 in the most recent quarter. This compared to profit interest income of $773,000 in the fourth quarter of 2017. The Company also incurred consulting fees of $116,000 under the consulting agreement in the fourth quarter of '18. This compares to consulting fees of $250,000 in the fourth quarter of 2017.

Our consolidated loss from continuing operations before income taxes totaled $470,000 for the fourth quarter of 2018. This compared to income from continuing operations for income taxes of $4,340,000 in the final quarter of 2017. The principal factor impacting this metric for the fourth quarter of 2018 was a termination fee of $4,560,000 related to the termination of the consulting agreement with Black Knight. The loss from continuing operations before income taxes for the fourth quarter of 2018 included total non-recurring transaction expenses of $4,715,000, up from non-recurring transaction expenses of $1,094,000 in the same quarter of 2017. Excluding the non-recurring transaction expenses, the Company's income from continuing operations before income taxes would have been $4,245,000 for the fourth quarter of 2018 compared to $5,434,000 for the fourth quarter of 2017.

The Company recorded net income of $934,000 for the fourth quarter of 2018 compared to net income of $5,340,000 in the final quarter of 2017. The results included an income tax benefit of $1,524,000 in the fourth quarter of 2018 compared to an income tax benefit of $1,105,000 in the final quarter of 2017. The tax benefit for 2018 was a result of a negative 66% effective tax rate driven in large part by the impact of FICA tip credits on lower pre-tax income.

Basic and diluted earnings per share totaled $0.06 for the fourth quarter of 2018 compared to $0.36 in the same quarter of 2017. Adjusted EBITDA was $7,364,000 in the fourth quarter of 2018, down $813,000 from $8,177,000 of adjusted EBITDA posted in the final quarter of 2017. For the final quarter of 2018, our restaurant operating profit margin as a percentage of net sales was 12.8% compared to 14.9% in the same quarter a year ago.

During the fourth quarter, we opened our newest Stoney River Steakhouse and Grill, bringing the number of restaurants in that concept to 13. This restaurant is in Troy, Michigan and is close to one of our high volume J. Alexander's locations. It performed very well during its inaugural holiday season and is off to a solid start for 2019. Also as we announced yesterday, we are looking forward to re-entering the Houston, Texas market during the fourth quarter of 2019 with our newest addition to the J. Alexander's Grill concept, which will be located in the Uptown Park district of Houston, Texas. We are pleased to report that all restaurant concepts have started the year with positive sales momentum. Much of this is due to successful gift card selling during the gift card season in 2018, with same-store gift card sales in our J. Alexander's Grill locations up 1.6% against the 2017 holiday season. Same-store gift card sales during the same period were up 12.3% for our Stoney River Steakhouse and Grill locations.

One measurement of how our restaurants are received in each local community is reflected by record sales days. During Valentine's week 2019, for example, we had 20 of our 33 J. Alexander's Grill restaurants set a record for Thursday sales, including our original location in Nashville which will be celebrating its 28th anniversary in a couple of months. On the Stoney River side, eight of the 13 restaurants posted record Thursday sales as well, thus on a consolidated basis of 46 restaurants, we had 28 locations record their all-time Thursday record sales day on Valentine's Day of 2019.

One issue we have again encountered during the first two months of the new year has been harsh winter weather in restaurants primarily located in our midwestern markets. This is similar to our experience during the same period of 2018 except that the 2019 weather events involved the polar vortex syndrome. This resulted in forced closures at numerous restaurant locations because many of our vendors were unwilling or unable to put their employees and their assets at risk under such extreme weather conditions. I cannot recall any time in our history where this has occurred. Through Valentine's Day 2019, we found it necessary to close our restaurants for a total of 11 days. This represented lost revenue during the quarter of $150,000 during the first six weeks of the year. During that same period in 2018, we were closed a total of 24 days, which accounted for an estimated loss of revenue of $370,000. As we remind each other internally on a regular basis, winter comes every year.

Beef prices through the first two months of 2019 are up mid-single digits compared to the first two months of 2018, but we expect them to be relatively stable to modestly up compared to historical trends as we look to the remainder of the year. We anticipate that we should be able to hold the line relative to cost of sales during 2019.

At this time, I would like to turn the call over to Mark Parkey, our Chief Financial Officer, who will deliver his remarks on the fourth quarter of 2018 and provide guidance for 2019. Mark?

Mark Parkey:

Thank you Lonnie, and good morning everyone. As Lonnie expressed in his opening remarks, our top line performance within the J. Alexander's Grill restaurants was softer than we had anticipated during the final quarter of 2018. On the positive side, our execution during the holiday season was solid and the measures we have taken to address our top line concerns, including steps to build additional traffic, appear to be generating the intended results.

Over at Stoney River, our operating results were robust with key financial highlights ahead of comparable results from a year earlier. The most encouraging statistic for the year at Stoney River was the solid guest count increase turned in by this group of restaurants.

The average weekly guest counts within the same-store base of the Company's J. Alexander's Grill restaurants were down 1.7% in the fourth quarter of 2018 compared to the fourth quarter of the prior year, while guest counts within the same-store base at our Stoney River restaurants were up 2.2% for the fourth quarter of 2018 over the fourth quarter of 2017. With respect to average guest checks, which included alcoholic beverage sales, the average guest check within the J. Alexander's Grill locations same-store base of restaurants increased by 1.9% during the fourth quarter of 2018 to $32.51 from $31.90 during the final quarter of 2017. The average guest check within the same-store base of Stoney River Steakhouse and Grill restaurants was $44.05, down 1/10th of a percent from the $44.09 average check in the fourth quarter of 2017.

The effect of menu pricing for the fourth quarter of 2018 was estimated to be 9/10ths of a percent increase for both the J. Alexander's Grill restaurants as well as the Stoney River restaurants compared to the last quarter of 2017. Inflation and food cost for the fourth quarter of 2018 was estimated to total 2.8% for the J. Alexander's Grill restaurants with beef costs increasing by an estimated 4.1% compared to the fourth quarter of 2017. At our Stoney River restaurants, inflation for the fourth quarter of 2018 was estimated to total 2.9% with beef costs higher by approximately 5.7% over the corresponding quarter of 2017.

The Company's restaurant labor and related costs as a percentage of net sales were 30.4% in the fourth quarter of 2018 compared to 29.5% of net sales in the final quarter of 2017. Other restaurant operating expenses were 19.5% of net sales in the fourth quarter of 2018 compared to 19.4% of net sales in the fourth quarter of 2017.

During his remarks, Lonnie provided the latest highlights from our announcement on November 30th of 2018 related to the termination of our consulting agreement with Black Knight Advisory Services. In accordance with the termination agreement, we wired a payment to Black Knight on January 31, 2019 of approximately $4,560,000 with funds coming out of our cash on hand. In addition to this payment, the Company is required to make a final payment of $705,000 to Black Knight within 10 days following the completion of our 2018 audit. We anticipate we will be wiring such funds to Black Knight from cash on hand on March 15, 2019.

Finally in accordance with the terms of the consulting agreement, the termination agreement and the 2015 unit grant agreement also entered into in connection with the spinoff and pursuant to which Black Knight was granted 1,500,024 Class B profits interest units of the Company's operating subsidiary, J. Alexander's Holdings LLC, Black Knight had 90 days from the effective termination date of November 30, 2018 to exercise rights relative to the fully vested profits interest units it held. Under the grant agreement, the profits interest units could be exchanged by Black Knight for shares of the Company's common stock if the market capitalization of the Company exceeded a hurdle amount of approximately $151,052,000 on a trailing five-day volume weighted average price during the relevant 90-day window. Black Knight profits interest grant expired on February 28, 2019 without a conversion of the profits interest related B units into the Company's common stock, and as a result the Class B units were cancelled and forfeited for no consideration.

During the fourth quarter, the Company's Board of Directors authorized a share repurchase program following the expiration of a program that had been in place since October 29, 2015. Under the original program, the Company repurchased 305,059 shares of common stock over a period of three years for an aggregate purchase price of $3,203,000 using cash on hand and operating cash flow to fund such purchases. The new repurchase program authorizes the Company to purchase up to $15 million of its common stock in the aggregate over a three-year period ending November 1, 2021. No shares have been repurchased during the fourth quarter of 2018 or thus far in Fiscal Year 2019. Any shares that are repurchased under the newly authorized program are expected to be made solely from cash on hand and available operating cash flow. Repurchases will be made in accordance with applicable securities laws and may be made from time to time in the open market. The timing, pricing and amounts of repurchases will depend on prevailing market prices, general economic and market conditions, as well as other considerations. The repurchase program does not obligate the Company to acquire any amount of stock.

Finally, the Company's performance outlook is based on current information as of March 11, 2019. The Company does not expect to update its 2019 guidance before next quarter's 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 range of guidance for Fiscal Year 2019 is as follows. Same-store sales for the J. Alexander's Grill restaurants are expected to increase by 1.0% to 2.0%. Same-store sales for the Stoney River restaurants are expected to increase by 2.0% to 3.0%. Capital expenditures are expected to range from $19 million to $21 million for the year, which includes construction of two new restaurants during Fiscal 2019 as well as eight major remodels, five of which will be in the J. Alexander's Grill group of restaurants and three of which will be in the Stoney River group of restaurants. In addition, we have ongoing maintenance expenditures ranging from $4.3 million to $4.9 million in that range as well as another $700,000 worth of IT-related capital expenditures and the completion of the pipeline that was in place at the end of Fiscal Year 2018.

Revenue for the year is projected to range from $253 million to $256 million. Net income will range from $10.2 million to $11.2 million. Adjusted EBITDA is expected to range from $27.2 million to $28.2 million. Our effective tax rate for the year is estimated to run from 2 to 6%, and our basic earnings per share is projected to come in at $0.69 to $0.76 per share.

I'll now turn the call back to Dana to open the call-in segment of this morning's call.

Operator:

At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. 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 using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question comes from the line of Will Slabaugh with Stephens. Please proceed with your question.

Will Slabaugh:

Yes, thank you, and first congrats to Lonnie, Mark, and Jessica on your new appointments - well deserved.

Lonnie Stout:

Thanks Will.

Will Slabaugh:

On the new openings, you talked about this in your remarks and the release as well, it sounds like you have some initiatives going both from a menu price standpoint, a messaging standpoint, but more broadly I was curious how these stores look in relation to previous openings that you've had, and if there are any red flags you would see in these new stores or just more of a typical ramp that you've historically seen for J. Alexander's.

Lonnie Stout:

Will, this is Lonnie. It's always difficult to estimate ramp on new stores. We did open a store in a new region of the country up in Philadelphia - that one has gone much slower than anticipated. That's not necessarily unusual for us when we go into a new region. We had the same thing happen to us several years ago when we went into Kansas City. It was a very slow ramp and ended up ramping to be a good restaurant. The first store we ever opened in Florida was in Fort Lauderdale and it ramped much slower than what we thought.

The other new stores, sort of all across the board, the Stoney Rivers (inaudible) a little bit strong (inaudible). We opened in Raleigh and it started sort of slow but now it's really starting to ramp up, and Lexington, Kentucky is sort of a slow ramper. But overall, we think they're all going to be good restaurants but certainly the store in Philadelphia is ramping very, very slow.

Will Slabaugh:

Understood, okay. Then on the pricing front, you mentioned some pricing rolled off at J. Alexander's. Where did you say you stood on the pricing right now year over year at J. Alexander's, and what might that look like for the full year, and then with Stoney River as well?

Lonnie Stout:

Sure. How much are we carrying right now, Mark?

Mark Parkey:

We are carrying on a cumulative basis about a percent on the J. Alexander's Grill side and about 1.6% on the Stoney River side.

Lonnie Stout:

And Will, we think we still have some pricing powder, but we decided in the fourth quarter to back off a little bit on pricing to sort of take a wait and see attitude. We're late in the business cycle, looking at some other restaurant groups we're seeing some guest count issues, so we just wanted to get a little better look at things and we'll make some pricing decisions down the road. If we feel good about the environment, we'll take them up, and if not, we'll go slow.

Mark, you want to color anything on prices?

Mark Parkey:

No, I think that's exactly what I would have commented on.

Will Slabaugh:

Then given the strength you're seeing, you mentioned Lonnie a second ago, with some of these new Stoney River openings, is there any thought that focusing more efforts and dollars toward opening more Stoney Rivers than relatively cheaper J's at this point, just given what I'm assuming is a slightly better ROI out of the gate there?

Lonnie Stout:

Well, we've certainly been watching that. I think what we told everyone a couple years ago when we turned Stoney into a lunch and dinner format because we didn't see any real advantage from a capital investment point of view of lunch versus dinner Stoney's, it was a very small increase in cap ex to have a lunch and dinner Stoney, and we're getting really good results.

One thing, if you notice, we cut our development really for 2019 to two units, and we think that's prudent, Will, based on that we've got several restaurants in the bubble up mode of starting to build sales, so we certainly wouldn't hesitate to do more Stoney's versus J's if we felt like over time that the Stoney's were going to ramp up easier. But, for the time being, we're going to do two as we announced for 2019, one of them in Houston, another one not to be announced, then we'll make rest of our decisions about 2020 later in the year. But we're certainly watching all the metrics of our new restaurant performance closely.

Mark, you want to—?

Mark Parkey:

Yes, I think to reiterate, the two we've got this year will be in the J's Grills side of the business, but a lot of it just kind of depends on market-specific factors and where we think it makes the most sense to put the next restaurant. If there's already—if we've already got a flag in the ground there, that will have an impact too, so it's just kind of case by case.

Will Slabaugh:

Great. Can you remind me when you said those two doors are going to open this year?

Lonnie Stout:

Yes, two.

Mark Parkey:

Both in the fourth quarter, Will,

Will Slabaugh:

Both in fourth quarter - okay.

Lonnie Stout:

We've announced one of them in Texas, a market that we've been in before, and we've got a restaurant in San Antonio, and I imagine—we hope that the other one's in Texas as well, but we're not in a position to announce the location yet.

Will Slabaugh:

Understood.

Mark Parkey:

Hopefully soon.

Will Slabaugh:

Lastly, can you talk about your capital structure as you see it today and how you're thinking about that, if anything has changed, I guess, post the Black Knight agreement being terminated? You've got net cash sitting on the balance sheet and cash flow that's looking to be positive despite the cap ex associated with these new units and the eight remodels that you mentioned, so I was curious if there was any willingness here to more aggressively repurchase shares at these levels?

Lonnie Stout:

Yes, I think there is certainly a willingness, Will, to aggressively repurchase shares. Obviously the share purchasing window was totally closed after we entered into the termination of the Black Knight agreement because they had a five day average to exercise their profit interest, which is totally expired now. So I would say our mood is to be more aggressive on share repurchase, and one of my new jobs as we transition here over the next few months is to work more closely with the Board on some shareholder value enhancements, and certainly aggressive buybacks of stock would be one of the things that the Board and I would be very interested in spending more time evaluating.

Will Slabaugh:

Okay, thanks a lot, guys.

Lonnie Stout:

Thank you, Will.

Operator:

As a reminder, if you would like to ask a question, please press star, one on your telephone keypad. One moment please while we poll for more questions.

There are no further questions at this time, and I would like to turn the call back to Lonnie Stout for closing remarks.

Lonnie Stout:

Thank you, and thanks everybody for being on the call today. As we noted at our regularly scheduled quarterly meeting last week, our Board of Directors approved several changes in the Company's Management leadership. Yesterday afternoon we issued a press release announcing the appointment of Mark A. Parkey to President and Chief Executive Officer. At the same time, I was named to the newly created position of Executive Chairman of the Board of Directors, and Jessica Hagler was appointed Vice President and Chief Financial Officer. All these appointments are effective May 1. Mike Moore, who joined me as our co-founder of J. Alexander's in 1991, will continue his duties as Chief Operating Officer and will assume some additional operational responsibilities. Finally, Frank Martire, who has been Chairman of our Board, is going to become our Lead Director of the Company.

It's truly been a joy to serve the Company for parts of the last five decades and lead this outstanding Management team. Given Mark Parkey's broad experience with the Company and his focus and high levels of integrity, I'm confident that he will be an outstanding Chief Executive Officer. I'm also extremely pleased that Jessica Hagler, who has served with distinction in several accounting and financial management positions with us since 2010, she will also be making her transition to Chief Financial Officer and I'm highly confident Jessica is going to do an outstanding job. I think Mark, Jessica and Mike head a very powerful team at J. Alexander's Holdings, and I look forward to continuing to working with them in the future, which we think is very bright. As we near the end of the first quarter of 2019, we have a long list of to-do items related to the full year, not the least of which involves ensuring that our newer locations ramp up as efficiently and successfully as possible. We're certainly focusing on that. We do believe that 2019 will be a good year and we anticipate continued success in all of our restaurant concepts.

Again, I want to thank all of you for joining this morning, and we look forward to communicating with you during the year.

Operator:

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