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J. Alexander's Holdings, Inc.

First Quarter 2018 Earnings Conference Call

May 4, 2018

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.*

Brian White, *Drexel Hamilton, LLC*

PRESENTATION

Operator:

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the J. Alexander's Holdings, Inc. First 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 the time for you to queue up for questions.

It is now my pleasure to introduce your host, Mr. Tom Lawrence, for introduction of our speakers. Please go ahead, Mr. Lawrence.

Tom Lawrence:

Thank you, Michelle (phon). We appreciate your interest in joining us on this conference call to discuss results of J. Alexander's Holdings, Inc. for the first 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. 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 December 31, 2017, filed with the SEC, which you can find on the SEC's website and the Investor Relations section of the Company's website.

Our non-GAAP measures disclosed in this call, the related GAAP measures, and other information are available in the financial and statistical summary accompanying the press release dated May 3, 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, May 4, 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.

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 everybody today. I have Mark Parkey with m, our Chief Financial Officer, and he will be on the call after my remarks.

We were pleased yesterday to report another solid overall performance for the Company, highlighted by positive same-store sales in both of our restaurant groups. Our average weekly sales, same-store, at J. Alexander's Restaurants and Grills were somewhat soft but acceptable at $120,100 per week which came in 0.3% ahead of results reported in the comparable quarter of 2017. We had strong performance from our Stoney River group which generated average weekly same-store sales average of $83,700 for the quarter, an increase of 6.2% compared to the first quarter of 2017. As we noted yesterday, our topline results in the first quarter were achieved despite the impact of adverse, harsh weather conditions in several of our Midwestern markets, and some unusual harsh weather in our southern markets. The inclement weather had more effect on our J. Alexander's Grills restaurants than it did on our Stoney River restaurants. We experienced severe winter weather in all three months of the quarter, with the most extreme conditions occurring during January and February.

On a consolidated basis, we had restaurant closings for approximately 27 days during the first quarter. There were numerous other days where we didn't close, but the weather had a negative impact on guest traffic, as these harsh weather conditions persisted. As a comparison, we had closings for a total of three days during the first quarter of 2017. Guest counts in our J. Alexander's Grill collections were down 2% on a same-store basis and down 2.5% on a consolidated basis during the quarter. We estimate a little over half of the same-store sales decline in guest count is attributable to the severe winter weather.

That having been said, we're always concerned when guest counts are down and we're glad to be passed the winter months of 2018. We are cautiously optimistic that our guest count trends will continue to normalize during the remainder of the year.

For the first quarter of 2018, net sales of J. Alexander's Holdings increased 3.5%, $61.9 million, up from $59.822 million in the first quarter of 2017. For the J. Alexander's Grill restaurants, as I said, average weekly same-store sales per restaurant advanced 0.3% from $119,800 in the first quarter of 2017 to $120,100 in the most recent quarter. Average weekly sales per restaurant for all of the J. Alexander's Grill locations increased 0.1% from $118,200 to $118,300 in the first quarter of 2018. Overall, our performance in the first quarter of 2018 for this group was as expected with the exception of the weather impact previously noted.

Though our sales growth in the first quarter was modest, we expect improvements as the year progresses. We are pleased on balance with results of our newer restaurants as they continue to mature.

For the Stoney River Steakhouse and Grill restaurant, average weekly same-store sales per restaurant rose 6.2% from $78,800 in the first quarter of 2017 to $83,700 in the most recent quarter of 2018. Average weekly same-store sales per restaurant for all Stoney River locations improved 6.2% from $77,900 in the first quarter of 2017 to $82,700 in the first quarter of 2018. The most recent sales results exceeded our expectations for the quarter and we continue to be encouraged with the progress that our Stoney River locations are making with each passing quarter.

As we noted in yesterday's release, we're particularly encouraged with the progress we're seeing in the Stoney River restaurant group as we continue to expand our lunch and brunch offering in markets where we have determined we can support lunch and brunch. Our lunch and brunch menus typically include lower-priced offerings which, by design, drive down average guest checks. However, we firmly believe that the more often our guests visit our restaurants, the most likely it is these guests will become part of the foundational base upon which all of our successful locations have historically been established. Six of our Stoney River restaurants are now serving lunch while nine locations offer brunch at least one day each week.

In our development program, we announced earlier this week the opening of our newest J. Alexander's Restaurant in King of Prussia, a suburb of Philadelphia. We're excited about this location. It is in a market that we have evaluated and worked on for several years. Most restaurants operating in this community tend to do very well; we're expecting to do the same. As previously communicated, our next Stoney River Steakhouse and Grill will be in Troy, Michigan. We are enthusiastically looking forward to the opening of this restaurant in the fourth quarter of 2018.

With respect to cost of sales during the first quarter of 2017, beef prices were extremely favorable, down 9.8% at J. Alexander's and the Grills and down 7.6% at the Stoney River group compared to the first quarter of 2016. Given such favorable pricing last year, we do not expect a repeat performance in the first quarter that just ended. While beef costs were up 2.7% at the J. Alexander's and Grill restaurants and up 3% at Stoney Rivers Steakhouse and Grill restaurants compared to the opening quarter of 2017, our input costs for beef were considered to be well within our normal range of expectations for the first quarter of 2018.

Total cost of sales as a percent of net sales in the first quarter of 2018 was 31.1%. This compared to 30.8% posted in the same quarter of 2017. Also impacting our results for the most recent quarter were transaction expenses of $926,000 related to our proposed acquisition of the Ninety Nine Restaurant concept originally announced in August of 2017. On February 1, 2018, we announced that we did not receive the required number of disinterested shareholder votes to approve the proposed acquisition and the merger agreement was terminated thereafter. The transaction expenses were primarily related to professional fees that we incurred during the first quarter of 2018.

Another significant item impacting results in the first quarter of 2018 was the valuation of the Black Knight Advisory Services, LLC, profit interest grant, resulting in a profit interest expense of $1.907 million, which was approximately $1.5 million higher than anticipated. Mark will discuss details of the profit interest grant during his comments in a few moments.

Income from continuing operations before income taxes was $1.842 million for the first quarter of 2018 compared to income from continuing operations before income taxes of $3.641 million in the first quarter of 2017. As mentioned, there were several primary factors impacting results for the most recent quarter of 2018, including the transaction expenses, the increase in valuation of the Black Knight Advisory Services profit interest, and the impact of preopening expenses associated with new restaurant openings and, to a lesser degree, the impact of new accounting requirements which affects the timing of recognition of gift card breakage. Excluding the impact of these items, income from continuing operations before income taxes would have totaled approximately as much as we posted in the first quarter of 2017.

Net income for the first quarter of 2018 amounted to $1.593 million, down from net income of $2.684 million recorded in the comparable quarter a year ago. Results include an income tax provision of

$138,000 in the first quarter of 2018 compared to an income tax provision of $844,000 in the corresponding quarter of 2017. Our basic and diluted earnings per share for the most recent quarter totaled $0.11 compared to $0.18 recorded in the first quarter of 2017. Adjusted EBITDA for the first quarter of 2018 was $8.151 million, an improvement of 7.2% or $550,000 from the $7.601 million in the first quarter of the prior year.

In summary, our performance was in line with our expectations for the first quarter. We believe it was a good quarter, particularly given the negative impact of the inclement weather on sales throughout much of January and February.

I will come back with some closing comment on the second quarter and the balance of 2018 in a few moments. I now turn the call over to Mark Parkey, our Chief Financial Officer. Mark?

Mark A. Parkey:

Thank you, Lonnie, and good morning everyone. In the first quarter-ended April 1, 2018, again, showed favorable results at the topline and we were also generally pleased with the Company's overall performance. There were no significant surprises operationally during the first quarter; only previous factors or issues that we discussed or mentioned in the last quarterly call. We've adjusted the estimated effective tax rate portion of our previous guidance to reflect the impact of the Tax Cuts and Jobs Act of 2017 and included this information in our earnings release yesterday.

Lonnie highlighted or covered in greater detail a few of the primary factors affecting us in the first quarter of the new year. Among those impacting income from continuing operations before income taxes was the increase in the valuation of the Black Knight Advisory Services, LLC profits interest grant, which resulted in additional profits interest expense of $1.495 million for the quarter-ended April 1, 2018 when compared to the previous valuation effective December 31, 2017. The Black Knight profits interest grant was issued in October of 2015 and requires a quarterly valuation. The non-cash expense or income associated with this grant is being recognized over a three-year vesting period which runs through October 6, 2018. It is calculated each quarter based upon the most recent valuation performed using the Black Scholes valuation model with any cumulative change associated with the most recent valuation impacting the most recent quarter.

Due primarily to the $11.45 per share closing price of the Company's stock at the end of the most recent quarter, coupled with a relatively short period remaining for the Black Knight profits interest grant to be amortized, an expense of $1.970 million was recorded. This compared to income of $39,000 in the first quarter of 2017. The Company also incurred consulting fees of $244,000 under our management agreement with Black Knight for the most recent quarter. This compared to consulting fees of $265,000 during the first quarter of 2017.

For the first quarter of 2018, our restaurant labor and related costs as a percentage of net sales were 29.4% compared to 30.0% of net sales in the corresponding quarter of 2017. Other operating expenses were 19.4% of net sales in the first quarter of 2018 compared to 19.3% of net sales in the same quarter a year ago. The Company's operating income for the first quarter of 2018 was $2.058 million compared to operating income of $3.794 million recorded in the corresponding quarter of 2017.

With respect to average guest checks, which include alcoholic beverage sales, the average guest check within the J. Alexander's Grill group same-store base of restaurants during the first quarter of 2018 increase by 2.5% to $31.86 from $31.08 during the first quarter of 2017. The average guest check within the same-store base of Stoney River Steakhouse and Grill restaurants during the first quarter of 2018 decreased 1.7% to $42.87 from $43.63 in the first quarter of 2017. Same-store guest counts at J. Alexander's Grills restaurants in the first quarter of 2018 decreased 2.0% over the corresponding quarter of 2017 while the Stoney River restaurants reported an 8.3% increase in guest counts over the first quarter of 2017 within their same-store base of restaurants. The effective menu pricing for the first quarter of 2018 was estimated to be an increase of 1.8% for the J. Alexander's Grill restaurants and a 0.2% increase for the Stoney River restaurants compared to the first quarter of 2017.

Inflation and food cost for the first quarter of 2018 was estimated to total 2.9% for the J. Alexander's Grill restaurant and at our Stoney River restaurants, inflation for the first quarter of 2018 was estimated to total 2.8%.

As Lonnie pointed out, beef prices at both our J. Alexander's Grills and Stoney River Steakhouse and Grill concepts during the first quarter of 2018 were modestly higher than the corresponding quarter of 2017. The Company's restaurant operating income margin as a percent of net sales was 15.9% for both the first quarter of 2018, as well as the first quarter of 2017. Consolidated general and administrative expenses were 10.5% of net sales in the first quarter of 2018 compared to 8.1% of net sales in the first quarter of 2017, an increase of $1.697 million. Most of this increase is related to the increase in the valuation of the Black Knight profits interest grant previously discussed.

The Company's performance outlook for this Fiscal 2018 remains unchanged, except for the estimated effective tax rate. As of May 3, 2018, we anticipate our effective tax rate will range from 1% to 7%, a decrease from the 10% to 16% range issued with our original guidance. The Company does not expect to updated this guidance before the next quarterly earnings release; however, the information on which the outlook is based is subject to change and the Company may updated its full business outlook or any portion thereof at any time for any reason.

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

Operator:

Thank you. We will now 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'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.

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

Will Slabaugh:

Good morning, guys. I wanted to ask an accounting question first. Mark, can you confirm how that $1.9 million charge from the revaluation of the Black Knight agreement was treated? It looks like it was not added back to the EPS number of $0.11. I just wanted to verify that as well as how it was treated in your Adjusted EBITDA number.

Mark A. Parkey:

Yes. The non-cash expense associated with that profits interest grant, Will, is added back for an Adjusted EBITDA impact, but it is not excluded from the earnings per share calculation. It's an expense in the earnings per share calculation, just like any other expense.

Will Slabaugh:

Got it. I was getting something like $0.11 from that if I were to add that back. I'm also wondering how you're thinking—about that as it relates to your guidance that you've given on EPS for the year.

Mark A. Parkey:

Well, there's a couple of moving parts in that. Obviously, the valuation at the end of the first quarter of '18 was higher than at year-end, so that's going to increase our expense, as we've disclosed, but our effective tax rate is lower, which will help our bottom line the other way. The net effect of those two adjustments ends up with our guidance still remaining appropriate for the year as originally issued.

Will Slabaugh:

Okay. Thank you for that. I wanted to ask about traffic at Stoneys which continues to be very strong. Can you talk about how steady that is across the system, and then any commentary around your newer units there would be very helpful as well.

Lonnie J. Stout, II:

Sure, Will. This is Lonnie. Traffic is strong across most restaurants. We've got one Stoney River that sort of the laggard on traffic and sales; traffic is up in all the rest of them. It's a mix bag of good reason—the lunch program in some of the restaurants, the brunch activity, and just an increase in our general sales at Stoney River. The restaurant that we designed originally, the Germantown Stoney River that's open for both lunch and dinner, is still the highest volume restaurant we have in the system and is still posting same-store sales increases. The restaurant we opened in Chapel Hill is dinner-only and has done well for us from a dinner-only point of view; of course, it doesn't generate the same volume it'd generate at lunch and dinner. We've decided to put a lunch in that location, just getting started on it. It's not that great of a lunch market, but we think the lunch will be profitable. As we said last year, going forward, all of our Stoney Rivers will be lunch and dinner locations and the one we're working on in Troy, Michigan will be a lunch and dinner Stoney location.

In summary on Stoney, a solid sales performance, and the traditional dinner day (phon) part, success at lunch in the locations we've rolled out and extremely successful brunch program that's constantly building sales in the locations that have brunch. Like I said, we do have one laggard in that group, but other than that, the same-store sales increases are across all restaurants.

Will Slabaugh:

Great to hear. Lastly, can you talk about your level of confidence in getting those stores open in '18 that you've outlined? It seems like you feel pretty confident there, so just wanted to verify that. Then also, I imagine your get fairly deep into 2019 at this point, so I was hoping you could give us an update there as well.

Lonnie J. Stout, II:

Yes. (Inaudible) are open and the Stoney River that we have scheduled for the fourth quarter, we're highly confident it will open, so that will complete the 2018 development plan. For 2019, I think we said three to four. We're still confident in that. We're in the final throws of negotiating leases on several locations. You have to have more things in the development queue than you're going to do, to be successful, and we do. Example, we're trying to put our restaurant in the Naples, Florida market. We have three opportunities there. We're sort of doing our due diligence and trying to determine which one's the best. We're looking at a Stoney River in the Henderson, Nevada market, but we have two sites that we're evaluating and negotiating on. We're still working our traditional markets for Texas. For instance, we have a lot of activity in San Antonio, Dallas, and Houston. So, we're very confident we'll hit our development objectives and probably on the second quarter call, we'll be able to talk some site-specifics about development.

Will Slabaugh:

Great. Thanks, guys and congrats.

Lonnie J. Stout, II:

Thank you, Will. Appreciate it.

Operator:

Thank you. Once again, as a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. 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 more questions.

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

Lonnie J. Stout, II:

Thank you, Michelle. As report in our press release that we issued yesterday, the first quarter of 2018 was marked by continued gains at the top line and met most of our key measurements in other areas. The winter weather is behind us. We anticipate that same-store sales in our J. Alexander's and Grill restaurant collection will move to more historical levels through the balance of the year. We're also looking forward to results which reflect ongoing continued improvement at our Stoney River Steakhouse and Grill collection during the remaining three quarters of 2018.

As I mentioned earlier, we're now serving lunch at six of the Stoney River restaurants. We're serving brunch at nine Stoney River locations. We are realizing positive trends in sales and guest traffic at these locations. We anticipate continued momentum within the Stoney River concept throughout the year as guest loyalty continues to gain momentum.

We appreciate everyone's interest and joining us on the call this morning. We look forward to communicating with you again as the year progresses. Thank you.

Operator:

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.