

Long-term Financial Overview

Jake Singleton, Chief Financial Officer

I'm going to use the podium, if that works. Can everybody hear me? Great. Sounds good. So again, I'm going to echo a lot of what Peter said, a lot of what I'm going to do today is table set. You guys have heard our speech, you've heard the pitch, we've gone through the investor decks together. I'm going to table set some things and then I'm going to get out of the way. We are really proud of the management team, the executive team we have in place so we're going to let them give you that, really the heart and the details behind it, but I'll just do a little table setting for you today.

Here we go. So another footprint, as of March 31, 454 clinics open across 33 states. Two shades there, the lighter blue, that's our regional developer territory that's covered. And now, again, we're doing this at the state level. So not all of each of those states are covered by an RD, but if it's in that lighter blue that is regional developer is covering some portion of that state. The darker blue is where we're still doing direct franchising.

So we've talked a lot in the past. Currently, we've got about – a little over 50% of the MSAs in the country are currently covered by regional developer and of our franchise units, a little over three quarters are under the purview of our RDE oversight right now.

And then where are we going? This is that same 1,700 that we've shown time and time again and this is our heat map. Again if you drill down in there, we've talked a lot in the past. There is 1,700 circles out there as to where we think we can place these clinics and have a high likelihood of success.

Richard Matthews, the gentleman that does the heart of this analysis is going to present today. So I won't butcher it up here right now. I will let him walk you through all the details. It's an amazingly deep dive into how we come up with this potential? We believe very strongly in this and this assumes no growth in the chiropractic market that Peter alluded to.

Growth strategy, same thing. That's our same dual strategy. This predominantly will always be a franchise concept. That will be the majority of the units in the system. And then we're going to complement that with our own corporate portfolio. So when you talk about the franchising side that is going to be led through the regional developer strategy. They are the key accelerant of what we're doing here. So we're going to leverage them. We're going to continue to leverage them.

And then you talk about our corporate portfolio, again that's a mix. It's either going to be greenfield units that de novo developments that we're going to do from the ground up or the acquisition of greenfield units and we're going to talk about those two tactics a little bit more here in a second.

But really in 2019, you can see that the momentum that we're on right now, Q1 2018 we sold 16 licenses, Q1 2019 we sold 13. You guys heard on our first quarter call they sold 30 licenses in April alone. Now again that's – some of that is driven by the timing of our franchise disclosure document, so kind of front loaded some of the quarter there, but to have 30 license sales in a month is incredibly impressive and that's the momentum that we're on right now.

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Clinical openings, again, doubling Q1 2018 to Q1 2019 and then we're back into corporate development. So when Peter came on board, we really shutdown the expansion of our corporate portfolio and we're back into that. So in Q1, we opened up those two greenfields. We also acquired a unit back. And then we also announced that in early April, we opened a third greenfield unit.

So going back to that first pillar, that franchise expansion strategy. Again, the RD model we believe very firmly that, that is going to be a key accelerant of our growth. We talk a lot about getting to that national scale of recognition, that 1,000 units, is that tipping point we want to get to. And the fastest way we're going to get there is to open as many storefronts as we can and we think the regional developer strategy is going to take us there.

So we've got 21 regional developer teams in the field right now. So for us, that's 21 people out there looking at real estate, 21 teams selling those licenses, 21 teams helping us with training, helping us with ongoing support and we're seeing that momentum. We talked about it. 22 licenses in 2016, 37 in 2017, 99 in 2018 and we've got 60 through April. We are seeing them accelerate. We talk a lot that if we're not seeing that acceleration, the strategy isn't as robust, they are absolutely performing to a high level. We're really excited about their progress. And then just a quick refresher on the economics there. For every license that they sell in their territory they receive a 50% split of that license fee. And then for their ongoing support, training and all other obligations, they do receive a 3% cut of that 7% royalty that we charge.

So then we go to the second piece of our strategy our corporate clinics. And really, those that have done a model or done some modeling on the company, it's a high cash-generative business. The unit economics are strong, we believe in our corporate clinics. So really we're going to talk a little bit more about how we are going to redeploy that capital and kind of continue to expand our corporate portfolio.

So three real ways that we can deploy that the capital. The first is really reacquiring those existing units from franchisees. The second, that de novo corporate greenfield development. And then third, is we can reacquire those regional developer territories kind of as they reach maturity and we can recapture that full economics.

So the first one we'll touch on is just a franchise unit acquisition. And really the objective here, it was the premise of the IPO. We know the unit economics of this business are exceptionally strong, so to go out and target some units that are out there, franchisees sell for a variety of reasons. We have the right of first refusal on any deal that is proposed to change hands in our system. Right now, we're focusing that in our current geography, so we have Southern California, Arizona and New Mexico is our current footprint.

So our current strategy is to continue to cluster where we have overhead. We're going to talk a little bit in a second what is the potential, where we could go for those additional unit acquisitions. So again, this was part of the premise of the IPO. Let's raise some capital. Let's go out there and start our own portfolio. I'll try to kind of give some historical background as to – we've done a number of these. We've done, I think, 19 transactions now, 17 kind of on the heels of the IPO funds. We did one reacquisition in 2018 and another one in 2019.

Now I wish we could get them all for 30,000. We're not going to see that. Again, these are very unique circumstances and franchisees, and – but you can see the average price of the kind of the early cohort there. It was about \$230,000 per clinic, but we have developed a kind of buyback analysis tool that we use. So we go through eight different kind of fields of criteria, and we grade each of those to kind of give us an idea as to what we feel as economically viable in terms of the valuation of that unit. Ultimately, it's a negotiation with that franchisee that results in the end purchase price, and we'll continue to focus on those opportunistically.

The second is that greenfield development. So we've opened three units so far this year: Azusa; Carlsbad; Flagstaff, Arizona. And again, part of the IPO, we went out and built 29 of these from the ground up across four states. We've talked a lot about – that's really where we got into an issue with some of the early performance of our portfolio, was that greenfield – those greenfield clinics, specifically in Illinois. So we turned a lot of those over to the regional developer there in Illinois. We ended up closing a few clinics, but we still very much believe in economics. And we'll talk a little bit later today how those new clinics are starting out and kind of the continued increase in that time to breakeven that we're seeing across the portfolio.

The other key stat I wanted to put out there is that we continue to evaluate the territory that we have. We believe that there is ample runway from us to continue this strategy. So Peter has talked a lot about in the past between 10% and 25% of the portfolio could come from corporate clinics. What we've looked at is that our current overhead structure is what we call an Area Sales Manager and a Clinical Director. That's our outside the four-wall overhead that we put in a kind of clustering of about eight to ten units as their level of oversight.

So what we did here is we just went out that same 1,700 circles that we looked at. We looked at all those territories and said, "Where is there at least eight? Where could we build out that level of overhead?" And so you can see there's still 250-plus clinics that could come in that purview of a market that holds at least eight units. If we step back and look at a market that just has four or more units, there's over 400 clinic potential if we look at something like that. So plenty of runway for us to develop our corporate portfolio in conjunction with our franchise strategy.

And then last is the regional developer acquisition. So again, not something that's new to us. A lot of the IPO friends were, again, dedicated to recapturing space for us to move into corporate clinic expansion. As we see the time line there. In 2019, we repurchased South Carolina. So a very mature market for us. It made a lot of sense for us to go in there and recapture that full economic potential.

There are continued runway. We have 21 of them out there. The key there is that we believe in the strategy. We are not going to go out and bring these people on to develop territory and then come back and buy out their territory. We've brought them into accelerate that growth. We will look at it when they mature. It's kind of a natural evolution of a franchise system that we would go back in if they're looking to monetize their asset or allow us to kind of continue our expansion footprint. So that'll kind of happen over time as we move into those opportunities. So really like I said, a high-level table setting.

I'm going to turn it over in just a minute here to our VP of Sales and Development that's kind of going to go to a different layer for you there. So I might ask also that we hold my questions until the end because I think a lot of them are probably going to be addressed by the team that's coming up. So really excited to introduce VP of Franchise Sales and Development, Mr. Eric Simon.