Disclosure: Long The Joint (NASDAQ:JYNT)

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Executive Summary

Clients of LVS Advisory are long shares of The Joint (JYNT).

The Joint is a franchisor serving the chiropractic care industry. The Joint enjoys several competitive advantages because it is the only national chiropractic chain and primarily competes vs. mom-and-pop operators. As a franchisor, Joint benefits from a high-margin, high-ROIC business model.

The Joint has significant potential for growth. The company has the capacity to double its unit count over the next decade and has several untapped levers to drive higher traffic and average unit revenue. The chiropractic industry is also poised for continued growth and Joint should take market share over time.

The Joint's stock price has declined in recent years due to the company's disastrous expansion of its corporate-owned units. However, the company recently announced plans to divest a majority of its corporate-owned units and become a focused franchisor. We believe this will lead to a re-rating in the company's stock and enable the company to drive improved systemwide sales growth.

We believe The Joint's stock could increase by over 200% over the next 3 years as it executes on the re-franchise initiative and continues to grow revenue and profitability.

Business Overview

The Joint (Nadaq:JYNT) is a franchisor of chiropractic clinics in the United States and operates the largest chiropractic chain in the country. The Joint has disrupted the chiropractic industry over the past decade. The model is to be the low-cost leader. It has a membership model where customers pay $89 per month for 4 chiropractic visits per month or pay $45 per single visit. On average, Joint customers pay $36 per visit which is 45% cheaper than the industry average[1]. In addition, the company is 100% cash pay (no insurance) and locates its clinics in high-traffic retail areas for better convenience. Compared to traditional chiropractic clinics that take insurance and are located in medical offices, Joint's clinics are cheaper, more accessible, and more consistent. This low-cost, no-frills strategy has enabled The Joint to scale quickly from 12 units in 2010 to over 900 units today.

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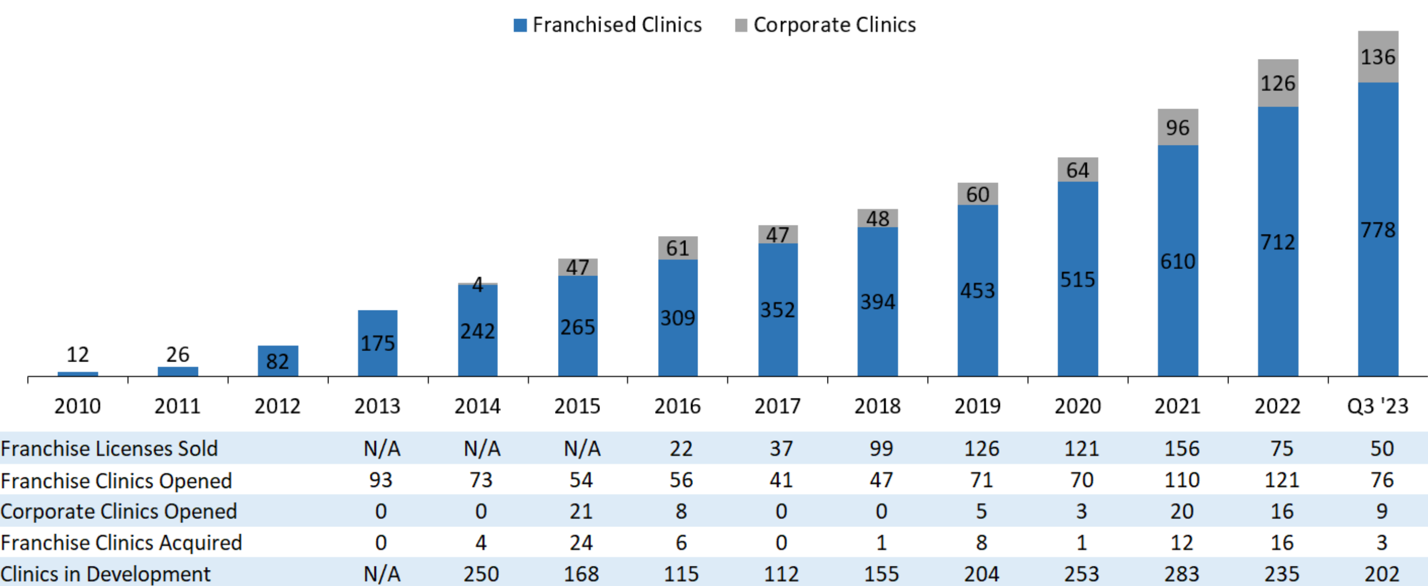
[1] 2022 study conducted by Chiropractic Economics.



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Q3 '23
Franchise Licenses Sold	N/A	N/A	N/A	22	37	99	126	121	156	75	50
Franchise Clinics Opened	93	73	54	56	41	47	71	70	110	121	76
Corporate Clinics Opened	0	0	21	8	0	0	5	3	20	16	9
Franchise Clinics Acquired	0	4	24	6	0	1	8	1	12	16	3
Clinics in Development	N/A	250	168	115	112	155	204	253	283	235	202

As a franchisor, Joint's business model is to recruit franchisees to open locations and then manage the brand to grow the system. Franchisees pay Joint a one-time licensing fee of $39,900 per clinic and then pay a 7% revenue royalty and contribute 2% of clinic sales to a national advertising fund. The total upfront cost of opening a location ranges between $200,000 and $500,000 which includes operating a clinic at a loss for the first year until reaching break-even profitability. On average, franchisee units generate $585,694 in annual revenue and earn $117,335 in 4-wall EBITDA, a 20% margin. It takes roughly 5 years for franchisees to pay back a new clinic investment which is in line with other major franchise concepts; however, at <$500k upfront investment, Joint has a much lower initial buy-in price.[2]

[2] Franchisee clinic costs and unit economics are sourced from The Joints 2023 Franchise Disclosure Document.

2022 Average Clinic Unit Economics

	Annual	Monthly
Revenue	$585,694	$48,808
Cost of Goods	$0	$0
Labor Expense	$267,324	$22,277
Sales %	*45.6%*	*45.6%*
Facilities Expense	$59,793	$4,983
Sales %	*10.2%*	*10.2%*
Insurance	$7,327	$611
Sales %	*1.3%*	*1.3%*
Other Operating Expenses	$81,202	$6,767
Sales %	*13.9%*	*13.9%*
Franchise Royalty Fee	$40,999	$3,417
Sales %	*7.0%*	*7.0%*
National Advertising Fund	$11,714	$976
Sales %	*2.0%*	*2.0%*
4-Wall EBITDA	$117,335	$9,778
Margin %	*20.0%*	*20.0%*

Source: 2023 Franchise Disclosure Document.

Franchisors are capital-light, high return-on-invested-capital businesses. Franchisees lay out the capital to open and operate locations and the franchisor, The Joint, collects a high-margin royalty. The franchisor is primarily responsible for brand management, recruiting and retaining franchisees, and incrementally improving the core concept. Demonstrating this point, The Joint's franchisor segment notched an EBITDA margin of 43.2% in 2022 with virtually no capex.

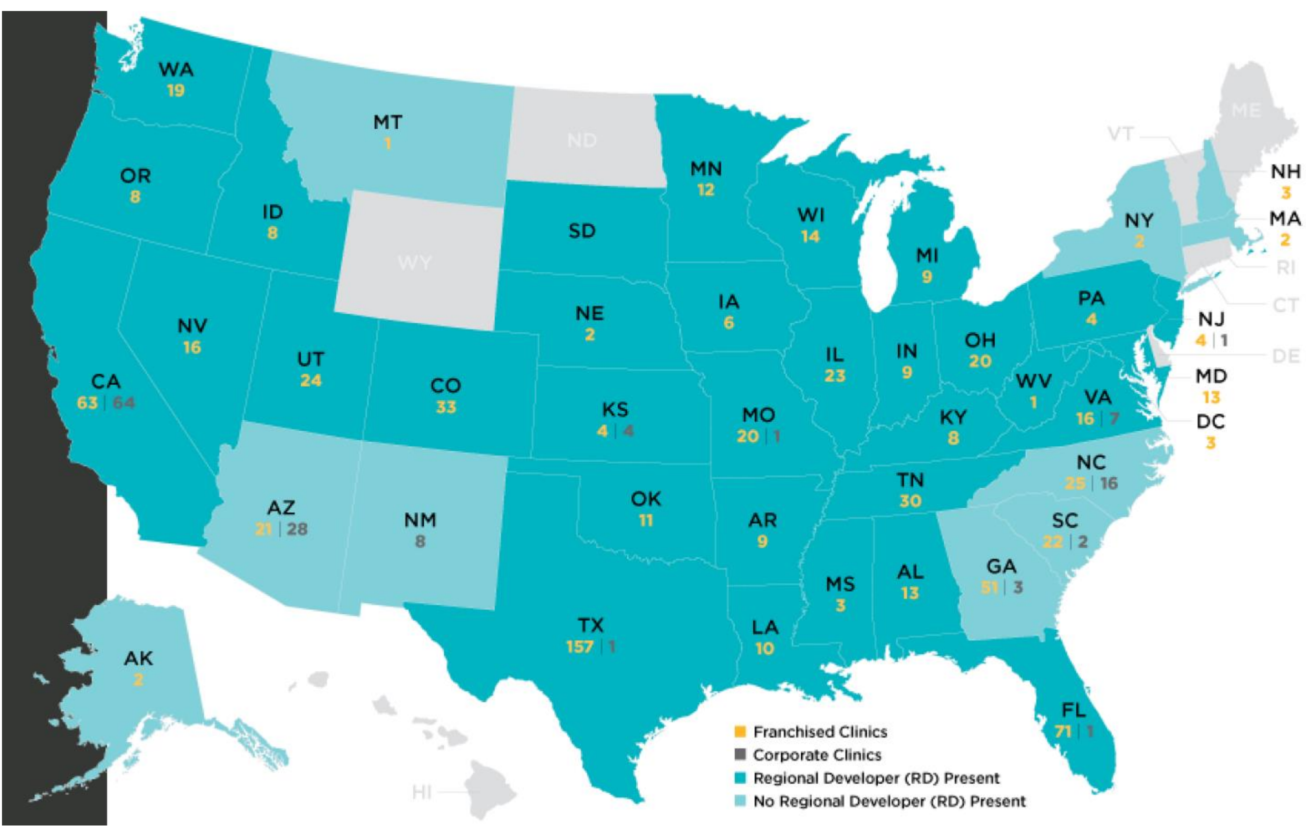
Recent Financial Results

	2021	2022	LTM
Franchise Segment			
Revenue	$35.7	$41.8	$45.5
Growth %	*33%*	*17%*	
EBITDA	$15.7	$18.1	$20.4
Margin %	*44.0%*	*43.2%*	*44.9%*
Corporate Segment			
Revenue	$44.3	$59.4	$69.3
Growth %	*39%*	*34%*	
EBITDA	$9.9	$5.7	$6.2
Margin %	22.3%	9.5%	9.0%
Consolidated Company			
Revenue	$80.0	$101.3	$114.8
Growth %	*36%*	*27%*	
EBITDA	$10.1	$7.5	$8.5
Margin %	12.6%	7.4%	7.4%

The Joint operates a portfolio of corporate-owned clinics. For reasons we will get to later, the company is in the process of divesting a majority of its owned clinics to effectively become a pure-play franchisor business.

With a network of 914 clinics, The Joint is the only national chiropractic chain and is over 5x larger than the #2 competitor. As a result, Joint benefits from several competitive advantages including more efficiency and scale in marketing (higher unaided brand awareness, lower CAC), better ability to hire and retain talent (licensed chiropractors are a cornered resource), and better support for clinic operators (franchisees) through management training and centralized technology investment.

There is still a long runway for unit growth. The company believes that it has the capacity to open up to 1,950 units in the United States, over 2x the current system. A quick look at The Joint's location map shows that there are obvious areas of white space. The company still hasn't penetrated several high-population states in the Northeast and has relatively low unit density in the Mid-Atlantic and Pacific Northwest. There is also the opportunity to expand internationally. There are many countries with strong chiropractic traditions including Canada, Australia, and Northern Europe.



Source: Joint Investor Presentation

There is also a long runway for improved comp sales and unit profitability. As the low-cost provider, The Joint has some room to increase prices without changing the value prop. There is also optionality to sell additional products and services. For example, most chiropractors sell equipment that can be used at home to stretch and/or lotions

and CBD oils to relieve pain; Joint doesn't sell any physical products in its stores today. Another big opportunity is selling corporate wellness plans as a part of employee benefit plans. Finally, we believe chiropractic services can be bundled with other complementary services such as massage therapy or gym membership as a kind of "wellness subscription"; these other services could be offered through strategic partnerships or potentially added within the existing 4-walls. Based on our conversations with the management team, we believe the company is working on several of these initiatives and we expect to see them introduced within the next 1 to 2 years.

Industry Overview

Chiropractic is a large but often ignored industry within the US healthcare ecosystem. There are over 41,000 chiropractic clinics operating in the US and while there is not good industry data, we estimate that the industry generates over $15 billion in annual revenue. The Joint generates systemwide revenue of approximately $500 million which implies a market share of around 3.1%.

The industry is highly fragmented with the vast majority of clinics owned and operated by independent practitioners. The Joint has obvious branding and marketing advantages vs. these less sophisticated operators. The Joint also has the ability to pay chiropractors more than the industry average due to higher average unit volumes at clinics. Chiropractors at Joint earn an average salary of roughly $100,000 vs. an industry average of $83,720.[3] The ability to hire and retain talent has proven to be an important edge in the current economic environment.

Traditional chiropractors take insurance which enables them to receive referrals from healthcare networks. There are pros and cons to this approach. However, we believe that Joint's non-insurance model is superior because dealing with insurance companies adds administrative complexity to getting paid. Not only does this cause doctor and staff burnout but as much as 28% of insurance billings are never collected by chiropractors[4]. At the end of the day, chiropractors that own and operate Joint clinics can earn more than twice as much vs. traditional clinics which supports the thesis that Joint can continue to take share from the traditional chiropractic model.

($ units in '000s)	Solo Chiropractors	Joint Franchisees
Patients Per Week	115	320
New Patients Per Week	6	21
Revenue Collected	$314	$586
Profit for Chiro Owner/Operator*	$92	$217

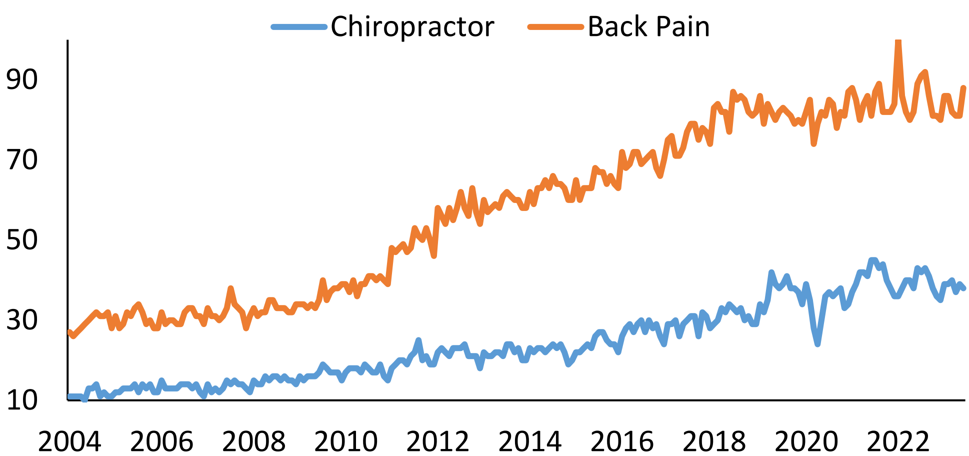
Source: 2022 study by Chiropractic Economics. Assumes Joint chiropractor pays themselves $100k.

Chiropractic is a growth industry. While there is no good data on the amount of revenue the industry has generated on an annual basis, census data shows that the number of chiropractors employed and the number of clinics opened has gradually increased over time. There is a secular increase in back pain due to demographic tailwinds and the industry presents a potent solution.

[3] The Joint's Salary figure is sourced from the 2023 Franchise Disclosure Document. The industry average is from the US Bureau of Labor and Statistics.

[4] Sourced from a 2022 study by Chiropractic Econoics.

Google Trends Data



There is also a growing acceptance of chiropractic care among healthcare professionals. In the past, chiropractic was not highly regarded because chiropractors do not graduate from medical school and the media has falsely correlated certain injuries with chiropractic care. In recent years top-tier medical institutions and medical journals have deemed chiropractic care to be safe and effective. For example:

- The Mayo Clinic has recognized chiropractic as safe when performed by trained and licensed chiropractors.
- The American College of Physicians (ACP) now recommends non-drug therapy such as spinal manipulation as a first line of treatment for patients with chronic low-back pain.
- A 2020 study published in Pain Medicine Journal found that 84% of physicians believe that chiropractors can provide effective therapy for musculoskeletal complaints and 65% agreed that chiropractic care was a useful supplement to conventional care.
- A 2018 study published by JAMA found that when done in conjunction with regular medical care, chiropractic care resulted in moderate improvements in low-back pain and disability.
- A 2016 study published in the Cureus Journal of Medical Sciences found no convincing evidence that there is a causal link between chiropractic manipulation and cervical artery dissection.

The professional sports world has also embraced chiropractic treatment. All 32 NFL teams and most MLB and NBA teams employ a full-time chiropractor. The US Olympic delegation employs chiropractors as an integral part of the medical team. And countless celebrity athletes including Tiger Woods, Tom Brady, and Michael Jordan, have noted that chiropractic care is integral to their training and recovery regimes.

There is still a large segment of the US population that is either unaware of chiropractic care or holds a negative view. We believe the Joint will benefit from a tailwind of rising acceptance that chiropractic care can assist in managing pain and overall wellness.

Joint's Recent Stumbles

The Joint was a statistically expensive stock before 2022; however, a handful of self-inflicted wounds have caused the stock price and valuation to crash in the last two years.

The Joint ran into problems in late 2021/early 2022 due to its decision to veer away from being a pure-play franchisor. Joint began aggressively opening company-owned units and almost immediately ran into issues. Perhaps in a stroke of bad luck, The Joint chose to expand its clinic count in a macro environment marked by labor shortages and rising inflation. New locations took longer to open, were more expensive than initially budgeted, and the company had difficulty staffing these locations.

The issues continued after the new locations were opened. To fight high staff turnover, Joint had multiple rounds of wage increases at its company-owned clinics. The company also added a new layer of "regional management" to support store clusters. Furthermore, AUV growth decelerated in 2022 and 2023, making it more difficult for the new corporate units to scale and be profitable. In total, The Joint opened 45 greenfield clinics from 2021 to Q3 2023 at an estimated total cost of $19.9 million ($10.2 million in capex and $9.7 million in opex investments) or $442k per unit.

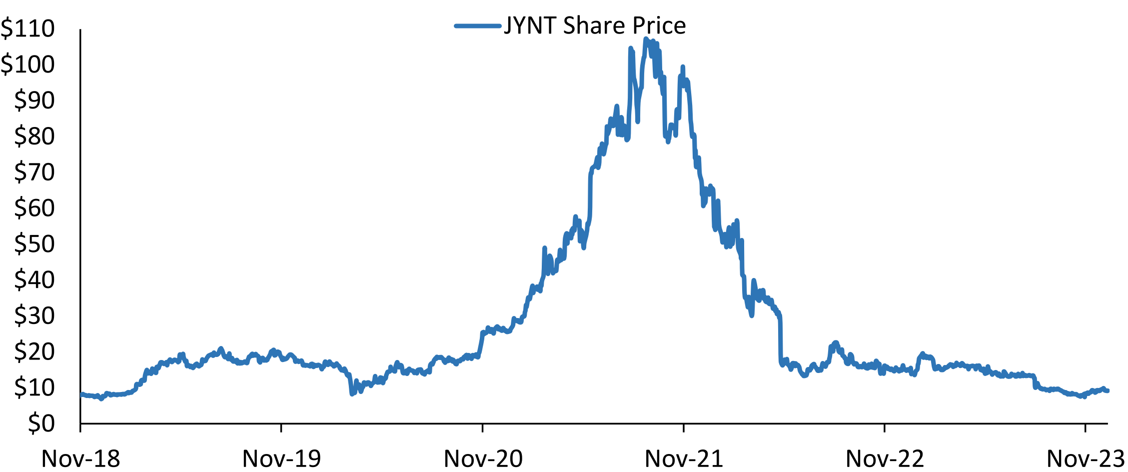
The Joint also decided to acquire 31 clinics from franchisees from 2021 to Q3 2023 for a total of $19.0 million or $613k per unit. The acquisitions were particularly bad because the company paid relatively healthy prices for "high-performing clinics" which then saw performance deteriorate due to cost and growth headwinds described earlier.

At the end of 2020, The Joint managed a portfolio of 64 clinics which generated $7 million in EBITDA ($109k per unit). As of Q3 2023, The Joint's managed portfolio consists of 136 units which generated $6.2 million in LTM EBITDA ($50k per unit). And of course, the company spent close to $40 million to achieve this outcome. The expansion of the corporate-owned units was undoubtedly a disaster for the company and destroyed tens of millions of shareholder value.

Business Transformation

The value destruction caused by the corporate-owned unit expansion has created an excellent opportunity for investors today. Shareholders puked the stock from a high of $111 per share in August 2021 to the current price of $9.20 (-92%). The stock trades at a multiple of 10x NTM EBITDA vs. 14x for the publicly traded peer group[5], a 40% discount.

[5] Peer group includes EWCZ, PLNT, XPOF, QSR, MCD.



This valuation discount would be warranted if The Joint were staying the course with its value-destructive strategy, but in November 2023, the company announced it would divest a majority of its corporate-owned units and become a pure-play franchisor. The company plans to re-franchise its corporate units by selling them to new and existing franchisees. The company will then be able to recoup some of the economics on those units perpetually by collecting its revenue royalties. Joint will also be able to cut costs associated with the corporate-owned units which are estimated to be as much as 60% of total unallocated corporate overhead expenses. Finally, the company will use the proceeds from selling units and the existing free cash flow to return capital to shareholders.

The company did not come to this decision on its own. LVS Advisory lobbied the management team and Board by confidentially writing a letter to the Board outlining the case for a corporate transformation and holding several phone calls with the relevant decision makers.

Joint's largest shareholder, Bandera Partners, also played a role. Bandera Partners owns 26.7% of the Joint and filed a 13D on August 8, 2023, indicating that the investment firm would actively engage with the company. On November 8, it was announced that Bandera's Managing Member Jeff Gramm would join The Joint's Board. The following day, The Joint announced the corporate transformation.

Bandera Partners is a seasoned activist hedge fund with a strong track record. Since its founding, Bandera has filed a 13D with 13 companies (including Joint) and has taken a board seat on 7 of those engagements. The average 3-year investment return of these 13 stocks following Bandera's initial 13D filings is 32.4% – this is a small sample size and doesn't normalize for industry/market factors but it is a good sign nonetheless. Furthermore, Jeff Gramm teaches a class at Columbia University on shareholder activism and has written the definitive book on the topic titled 'Dear Chairman' (2016) which I have read and highly recommend. This is all to say that Joint shareholders should be thrilled to see Jeff Gramm joining the Board.

There is a lot to like about The Joint's current position. The company has a clean balance sheet which consists of $14 million of net cash vs. the company's market cap of $138 million and has remained profitable and free cash flow positive. The Joint's franchise segment is still a crown jewel asset. Despite a rough patch for the corporate-owned units, the franchise system is healthy. Franchised units have continued to grow, post positive comps, and

remain profitable. Despite choppy comps, the franchise segment has reported YTD revenue growth of 11.8% and an LTM EBITDA margin of 44.9%.

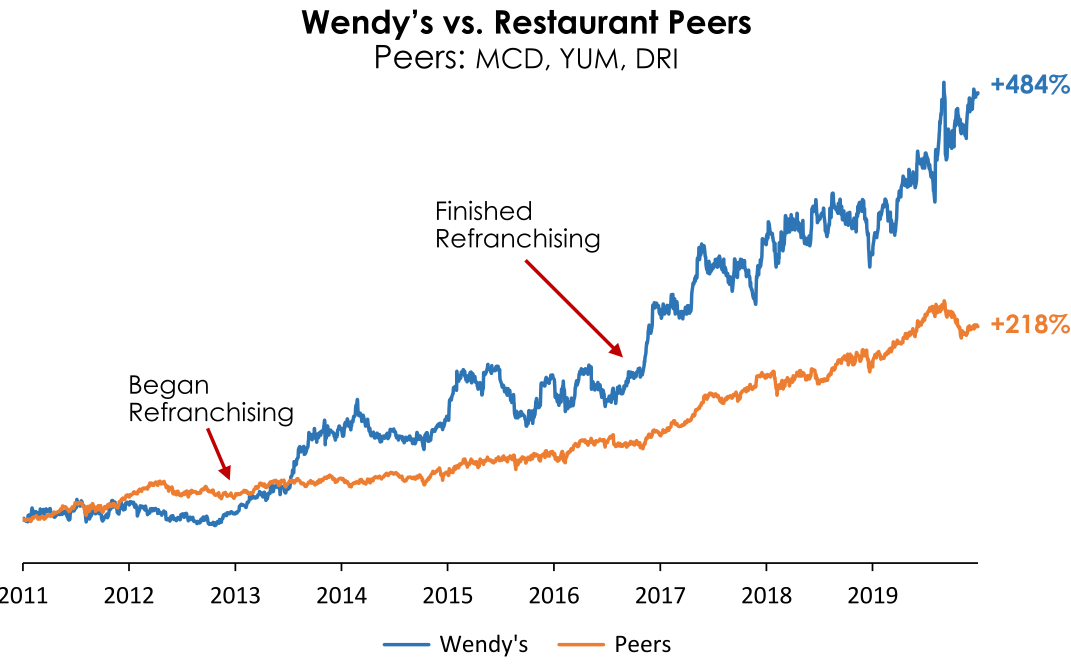
The Joint's franchise business is likely to improve following the re-franchise of corporate stores for a few reasons. First, the company-owned stores under-performed franchised units on revenue, profitability, and talent management. It just makes sense that experienced multi-unit operators with a strong incentive will outperform an unfocused corporate owner. This alone could lead to a re-acceleration in comp sales. Second, Joint's management team has been distracted by the expansion and turnaround of the corporate-owned units. A more focused franchisor will more effectively execute on the basic blocking and tackling needed to expand the system and drive traffic. Third and finally, the more focused Joint will drive incremental improvements to the core clinic concept. For example, the company can experiment with and execute on some of the incremental revenue opportunities described earlier. The legacy business strategy simply wasn't focused enough or incentivized to pursue some of these initiatives that could drive improved unit volume and customer retention for franchisees.

On the other side of the corporate transformation, The Joint's franchise segment could compound value for years to come. The system currently has 914 units but has the capacity for closer to 2,000 units. There is no reason why Joint's system can't double over the next 10 years. There are 202 clinics in active development which implies 20%+ unit growth over the next 2-3 years. As The Joint's system continues to scale, the business model should also see attractive operating leverage on its fixed cost base and generate significant incremental cash flow. There is little need for capital reinvestment and the company has already committed to initiating a capital return program once the corporate transformation is underway.

Re-franchise Case Studies

We have studied several case studies of re-franchise transactions at public companies. Some of the notable precedents worth reviewing include Jack in the Box re-franchising over 1,000 units from 2008 to 2013, Yum Brands re-franchising its 2,300 Chinese units from 2017 to 2022, and Denny's re-franchising 105 units in 2019. In almost every precedent we studied, the companies that executed the re-franchise transactions saw their stock prices outperform in the following years. A more recent example worth noting is Potbelly (PBPB) which announced a plan to re-franchise its units in March 2022 and has seen its stock price double in the 18 months since.

Our favorite case study demonstrating the benefits of a re-franchise is Wendy's which re-franchised 1,118 units between 2013 and 2016. Through the re-franchising, Wendy's was able to improve EBIT margins from 4.9% in 2012 to 21.9% in 2016. Before the re-franchise Wendy's traded with a forward EBITDA multiple of 8x; by 2019 Wendy's had re-rated to 20x. Wendy's stock price tripled from the beginning of the re-franchise to the conclusion of the program but continued to compound and outperform its industry peers for many years following the transaction. We believe the re-franchise unlocked the company's ability to execute and served a purpose greater than just "financial engineering".



Valuation

So, what is The Joint worth?

The Joint currently sports a market cap of $138 million and is conservatively capitalized with $14 million of net cash.

JYNT Capital Structure

Share Price (12/20/23)	$9.20
Diluted Shares	15.016
Market Cap	$138.1
Cash	$16.1
Debt	$2.0
Enterprise Value	$124.1

The table below summarizes how I believe the re-franchise could impact the way investors value The Joint today. However, given that Joint is a growing business, I also highlight what Joint could be worth in 3 years with conservative assumptions.

Valuation Summary

	Joint Today	Post Re-Franchise 2023E	Post Re-Franchise 2026E
Franchise Revenue	$45.5	$49.8	$78.1
Franchise EBITDA	$20.4	$22.4	$36.5
Margin %	44.9%	44.9%	46.7%
Corporate-owned Revenue	$69.3	$6.9	$7.4
Corporate-owned EBITDA	$6.2	$0.6	$0.7
Margin %	9.0%	9.0%	9.0%
Total Revenue	$114.8	$56.8	$85.4
Corporate overhead	($18.2)	($12.0)	($13.9)
Consolidated EBITDA	$8.5	$11.0	$23.3
Enterprise Value	$124.1	$154.0	$325.6
Implied Multiple	14.6x	14.0x	14.0x
Plus: Net Cash	$14.1	$14.1	$14.1
Equity Value	$138.1	$168.0	$339.7
Proceeds from clinic sales	$0.0	$36.0	$36.0
2024 - 2026 FCF Generated	$0.0	$0.0	$39.0
Adj. Equity Value	$138.1	$204.0	$414.7
Diluted Shares	15.016	15.016	15.016
Share Price	$9.20	$13.59	$27.62
Upside		47.7%	200.2%
MOIC		1.5x	3.0x

Joint's Estimated Value Today Post Re-franchise:

- The franchise segment currently generates $20m in EBITDA.
- There is currently $18m of corporate overhead. We believe that at least half of corporate overhead is tied to the corporate-owned units and will be eliminated in the next 1-2 years; however, for conservatism, we assume only one-third of corporate overhead is eliminated which equates to ~$6m.
- The corporate clinics generated $69.3m in LTM revenue and we assume 90% will be re-franchised. Joint will charge a 7% sales royalty on the re-franchised units. If one assumes the current 45% EBITDA margin, this equates to roughly $2m of incremental franchise EBITDA.
- The remaining corporate clinics should still generate around $0.6m of EBITDA.
- Adding it together, implies that a post re-franchised Joint will do around $11m of EBITDA today ($20.4 - $18.2 + $6.2 + $2.0 + $0.6).
- Applying the current peer median valuation multiple of 14x implies an enterprise value of $154m.
- To get to equity value you must add the $14m of net cash.

- You must then add the proceeds from selling the corporate clinics to franchisees. We believe Joint's clinics are worth anywhere from $200k to $600k per unit (replacement cost is ~$400k per unit). Given that Joint is a forced seller, the per unit proceeds received will likely be closer to the lower end of the range. Assuming $300k per clinic for selling 120 units (90% of the owned portfolio) equates to $36 million in total proceeds.
- $154m + $14m + $36m = $204m in total equity value post re-franchise, or 47% greater than the current market cap of the stock.

Joint's Estimated Value in 2026E Post Re-franchise:

- We modeled a few key growth assumptions to bridge Joint to our estimate of 2026E
  - 70 new franchise units added per year, consistent with the pre-covid trend
  - Average comp sales growth of 2%, implies a recovery from current flat/down comps
  - Annual fixed cost inflation of 5%
  - 2/3 of EBITDA is converted to free cash flow after $2m of annual capex and taxes are paid
- We estimate total company EBITDA will more than double to $23.3m
- After adding balance sheet cash, proceeds from the sale of clinics, and cash flow generated over the next 3 years, we arrive at an equity value of $414.7 million which is 3x above the current market cap

Key Investment Risks and Mitigating Factors

- The business transformation will require strong execution by the management team. Are they up to the task?
  - Peter Holt has been the CEO of Joint since 2016 and has a strong background in the franchise industry having served as the CEO of Tasti-D-Lite, a frozen yogurt chain that was successfully sold. The biggest knock against Peter is that he led Joint through the disastrous period where the company mismanaged its expansion of corporate-owned stores. Our view is that the management team's core expertise and background is in franchising and that the business transformation to become a pure-play franchisor plays to their strengths. We also believe it is easier for a company to get smaller and more focused than the opposite. When Peter first joined as CEO of Joint he oversaw a similar turnaround at the company. Between 2016 and 2021 the company significantly expanded its franchised unit base while holding corporate units flat, generated annual double digit comp sales growth, and went from money losing to being highly profitable. We believe Peter has it in him to execute a similar turnaround.
  - We are also comforted by the oversight from Bandera Partners and their board seat. Bandera has steered several companies from the brink of failure to success. If the current management team and Board are not up to the challenge, we believe Bandera will help ensure the right management team and board is appointed.
- How will an economic downturn impact demand for Joint's services?
  - An economic downturn would certainly have a negative impact on patient visits and comp sales trends at clinics. The Joint experienced strong growth and profitability during the brief recession

experienced in 2020; however, the company has not experienced a more prolonged economic downturn.
  - The Joint's services are not highly discretionary because most customers regularly visit Joint as a part of a healthcare or wellness routine. Furthermore, a decline in comparable sales will be offset by continued unit growth and the maturation of recently developed clinics.
- Will Joint be able to continue attracting high-quality franchisees?
  - The Joint's model relies on attracting new franchisees to grow the system. The volume of new franchise licenses sold has dropped in recent quarters and there is a risk of fewer banks and investors becoming interested in financing new locations during a recession. While this risk could be pronounced in the coming year, The Joint has an untapped potential to court more sophisticated multi-unit operators. There is significant whitespace remaining to fill out the company's geographic footprint and the concept remains one of the most compelling franchise investments available.
- Will Joint be able to improve its comp sales trends?
  - In recent quarters the Joint's comp sales trends have deteriorated. The company reported a flat comp in Q3 2023. We believe the flat/down comp trends will continue in the near term but comps will gradually improve as the company executes its re-franchise initiative. In our view, the company-owned stores were hurting systemwide comps due to suboptimal management. Furthermore, the Joint will be able to more effectively drive new marketing and other growth initiatives as a more focused company.
- Will Joint be negatively impacted by competition?
  - There are a handful of other chiropractic franchises that have copied The Joint's business model. However, The Joint is over 5x the scale of the next largest player and maintains a significant first-mover advantage and brand awareness. There does not appear to be a specific competitor that poses a serious competitive risk at this time.
- Will consumer preferences shift away from chiropractic services for pain management and wellness?
  - Chiropractic services have gained popularity in recent years and could fall out of favor. However, chiropractic care is not a new trend and has a tradition that can be traced back to the 1800s. Furthermore, the drivers of increased adoption are a growing number of back pain cases and growing acceptance and approval by the medical community. The rise in back pain is likely to continue as demographics age and more people embrace a sedentary lifestyle.

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