We first pitched the Joint Corp. publicly at MOI's Best Ideas in 2019, and these are our updated thoughts on the business given the pandemic.

Competitive Advantage

The Joint Corp. is a chain of chiropractic clinics. In our opinion, the company's long-term competitive advantage remains strong. Its model is unique in a fragmented field of independently offices. The Joint Chiropractic is expanding the market for chiropractic services by offering affordable adjustments. They do not take insurance. Patients pay direct, and 76% of their sales are made through monthly wellness plan that costs $79 (for four visits) or less; additional visits cost $10. They are typically located next to the dominant supermarket, gym, or a leading retail center in a neighborhood. Patient visits are quick (that take as little as five to ten minutes) and affordable. As a result, they are “revolutionizing access to chiropractic care.”

Typically, patients experience hour-long visits to chiropractors, who are trying to justify big claims to insurance companies. The higher fees charged and the extra time spent (e.g. x-rays, MRI, etc.…) create friction that inhibit most patients from receiving the frequency recommended. As a result, few patients see their chiropractor the recommended three times a week (when starting a new treatment). The Joint is set up differently. There are no appointments needed, clinics typically open longer hours and on weekends, patient visits are shorter, and the cost is much lower. Patients are more likely to receive the care they need under this model.

At the Joint, it costs $119 to $159 for eight to twelve visits in the first month. Other chiropractors charge significantly more. According to a survey by Chiropractor Economics, the average co-pay is $32 per visit. Approximately 91% of Americans have insurance, and would therefore pay $256-$384. For the 9% of Americans without insurance, the cash cost is $77 per session, and the first month of treatment could cost from $616 to $924. As a result, the Joint delivers substantial savings. We believe the Joint will (1) increase the number of patients who would use a chiropractor and (2) increase the number of visits from those who already use a chiropractor.

While the Joint will focus on growing market share for the foreseeable future, we believe they have 3% pricing power per annum.

Covid-19 is a key risk, but creates long-term opportunity

Like all retail businesses, covid-19 is a key risk for the Joint Corp. Unlike most businesses and many clinics, the system remained open during the pandemic. There were some greenshoots in May, but gross sales were down 30% in April. This has tempered our near-term bullishness on the stock, but we believe the pandemic creates a long-term opportunity. It may be a net positive for the chain as they emerge stronger than the competition. From our conversations with chiropractors and loan officers, we believe many self-employed medical professionals are poorly positioned to navigate this pandemic. While experts in their field, many lack strong business management skills. They may be skilled at treating patients but may be poor at sales. In some extreme cases, chiropractors have accumulated hundreds of thousands in credit card debt when they were qualified for lower interest SBA loans. This pandemic may force competitors to close, and this would reduce competition and increase the labor pool for the Joint Corp.

The Paycheck Protection Program (PPP) covers labor, which represent most of a clinic's operating costs. Despite the significant drop in sales, we believe monthly operating income remain unchanged due to PPP at the clinic level. This outperformed retail as a whole and enhanced the system's confidence in the model. While there could be a second wave, without another tranche of PPP, we believe the system has been given additional time to better prepare.

According to our channel checks, new openings were temporarily paused for two months. But they have since rebounded to pre-pandemic levels. Sales of new licenses have dropped this year, but they are still being bought by new and established franchisees. The franchise community remains bullish.

According to our conversations, national and regional landlords believe in this concept, so they want the Joint in their center. Given the weak environment caused by the pandemic, landlords are willing to offer significant tenant improvements and even up to six-months of free rent.

The pandemic could force some weaker units in the Joint system to close. Like all systems, some clinics underperform. The pandemic could also encourage some franchise owners to sell their units. We expect management will purchase an increased number of units this year. There is also the risk that a second wave in the fall/winter temporarily halts new openings. As a result, we expect unit growth will slow to 0-5% this year: ~0% if there is a second wave and ~5% if there is not.

We expect growth will rebound to 5-10% in 2021 and 10-15% in 2022.

Improving Access/Growing Market Share

According to our research, there is a significant opportunity to grow access to chiropractic care. The average clinic in the Joint system has ~0.7% market share in their local market. This contrasts with the ~20.0% of Americans, who suffer from chronic pain. As the price leader in the industry, we believe the Joint Corp has a secular growth opportunity. Each clinic can continue to grow average unit volumes at an above average pace.

The clinic benefits from a shift from opioids toward natural treatment options. The chain's clinics are also helped by good reviews that typically range from 4.0 to 5.0-stars on Yelp. Customers walk out satisfied and recommend the chain to their friends. Some have even become franchisees. The stores help people save time and money, while alleviating pain. Approximately 40% of its patients are referrals from customers.

We believe the Joint is creating an emerging nationwide brand, that is gaining awareness organically and through marketing. On average, the chain spends $10-15 in marketing to acquire new members from digital channels. They stay an average of 6-months. While memberships have a short duration, this generates a strong LTV-to-CAC.

The chains marketing strategy has helped same-store-sales grow 20%+ for over five years in a row, which is an exceptional accomplishment in the retail. In my opinion, strong performance should continue given the low penetration, value proposition, low organic awareness, and attractive ROI on paid marketing.

Once the pandemic is over, we expect SSS can grow between 8.0-11.0% long-term. This chain is unique in retail. Its above average SSS will help drive significant profit growth at the clinic level.

Strong Unit Returns

The management team believes in its own concept. The calculus for building company-owned stores is attractive and will have a material impact on profit growth. A single company-operated clinic could add one hundred thousand dollars a year in operating profits.

We believe there is a strong medium-term runway to build high-performing stores. The Joint's model is unique in retail because they have un-matched demographic data from patient intake forms. Buying outside data and investing in analytics, have helped them improve site selection capabilities. We believe this is part of the reason new openings were improving at such a rapid rate pre-Covid. Some grand openings shattered old records and reached profitability in as little as a month. We spoke to one of these franchisees and their playbook is replicable. New units overall are hitting break-even in six to nine months.

The Importance of Regional Developers

We believe the recruitment of regional developers (RDs) has reduced risk in the franchise segment and position the it for stronger growth. The corporate team invested in these partners, in part, because it frees them up to invest in corporate stores. In this difficult time, we believe some RDs are a source of capital for franchisees.

RDs are experienced franchisees, who have been given the incentives to recruit, guide, mentor, onboard, and monitor other franchisees. In my opinion, the RDs provide two significant benefits (1) they de-risk franchise operations and enable management to shift their attention to corporate new-builds and (2) they recruit new franchisees to help sustain growth.

The last team largely ignored the franchise system, while building out the initial portfolio of corporate clinics. Ultimately, this decision weakened the chain as franchise performance suffered. By recruiting RDs, we believe this management team will succeed where the last one failed. These partners will help the current management team provide the proper level of support franchisees require.

We believe the company has laid the groundwork needed for a big ramp in company-owned stores. They have recruited RDs and made investments in overhead. In 2019, they opened 5 greenfield units and acquired an additional 8 clinics. We believe the company will eventually have closer to 200 company-owned units in six or seven years, vs. ~60 today.

A High-Quality Business

As Warren Buffett put it – "the best business is a royalty on the growth of others, requiring little capital itself." This is a leading franchise that generate strong returns on investment (ROI) at the clinic level, which creates the incentive to open new locations and grow the franchisor's royalty stream. We believe franchisees and RDs believe strongly in the chain's ability to grow market share, driving AUV growth and increasing clinic profits. Stronger ROIs will help the system sustain strong corporate and franchise unit growth.

Compared to other retail concepts, we believe these units are relatively easy to operate. In fact, one top-performing franchisee told us that he had not visited his locations in four months. He keeps in close contact with his team and monitors their performance remotely. Approximately 66% of owner's are not a Doctor of Chiropractic. As a result, there not much for an owner to do at each location. Their time at the store is spent, boosting moral (e.g. buying lunch or coffee) and troubleshooting issues. Most of their value add, is looking for key performance metrics that need to be addressed. Community outreach is also important. As the ROIs get stronger, we believe this business opportunity will sell itself.

Growing the number of units

The chain could sustain 10%+ unit growth for the foreseeable future.

There are ~470 franchise locations and ~60 corporate clinics. The corporate management team estimates 1,800+ total units, but we believe this number is way too conservative and will be raised significantly in the future. The TAM analysis has not been run in years. Since then, average unit volumes have grown significantly as the business gains awareness. Clinics are more profitable now than before. If the analysis is run again, we believe the chain can open at least 2,200 units. We have spoken to franchisees and to commercial brokers and believe there could be twice the # of locations in some urban centers and suburbs. In addition, the management team is starting to look at alternative locations, a special design in less densely populated areas, and international expansion (source – 5:33). The opportunity in the U.S. on its own is already massive. Chains in the chiropractic industry, control a fraction of the total market – ~39,000 clinics. But chains in other verticals dominate up to 50% of their industry.

Valuation

We believe this is a leading retail concept, that is franchised and can deliver ~10% unit growth and ~10% SSS growth long-term. The clinics each have a competitive advantage in their local market, offering low-cost chiropractic care in convenient locations. Given the value proposition of their service, we believe they have long-term pricing power but expect them to focus on gaining market share.

In five years, we expect the chain will have closer to 900 or 1000 units, vs. ~530 units. Average unit volumes will be $650-675K+, vs 450-500K today. At that point in time, we believe the system will still be growing 10-15% a year to a unit potential of 2,200+. The average clinic will have market share of ~1% and could still grow 5-7.5%+ through a combination of share gains and pricing power.

Given the franchise model and the operating leverage at the clinic level, we believe operating margins are heading toward ~25% over the next five years. We believe this will drive EPS to ~$1.90 in 2024. At that point in time, we believe 25x+ EPS would fairly value this stock for its 20-25% EPS growth potential.

We believe the Joint Corp. will be worth ~$47.50 in 4-5 years.

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