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GNC - Q4 2019 GNC Holdings Inc Earnings Call

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PRESENTATION

Operator

Welcome to GNC Holdings First Quarter 2019 Earnings Call. (Operator Instructions) Please note this conference is being recorded. I will now turn the conference over to Matt Milanovich, Head of Investor Relations. Thank you. You may begin.

Matt Milanovich - *GNC Holdings, Inc. - Senior Director of IR, Analysis & Strategy*

Good morning, and thank you for joining us for GNC's Fourth Quarter 2019 Conference Call. I would like to remind everyone that during this conference call, GNC management will make certain forward-looking statements about its outlook that involve risks and uncertainties.

Forward-looking statements are generally preceded by words such as believe, plan, intend, expect, anticipate or similar expressions. Forward-looking statements are protected by the safe harbor contained in the Private Securities Litigation Reform Act of 1995. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict, and many of which are outside of the company's control. Factors that could cause actual results to differ from expectations include, but are not limited to, those factors set forth in GNC's filings with the SEC. GNC is making these statements as of March 25, 2020, and assumes no obligation to publicly update or revise any forward-looking statements. In addition to the GAAP results, GNC will provide certain non-GAAP financial measures. GNC's earnings press release for the fourth quarter of 2019 can be found under the News Release link on the Investor Relations page of the company's website at www.gnc.com. The tables attached to the earnings press release include reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures.

With that, I'll turn it over to our Chairman and CEO, Ken Martindale.

Kenneth A. Martindale - *GNC Holdings, Inc. - Chairman & CEO*

Thank you, Matt. Good morning, everyone, and thanks for joining us this morning on short notice. We find ourselves in uncharted waters right now. I'd like to begin by acknowledging all of our tremendous associates in the stores, supply chain and offices as well as our committed franchise partners who have been working tirelessly to provide health and wellness products to communities around the world that they serve. I'd also like to extend our sympathies and best wishes to the thousands of people who've already been terribly impacted by the spread of COVID-19.

Let's start by talking briefly about our fourth quarter results. Comparable sales in our U.S. stores were softer than we would've liked, but our e-commerce business delivered a 15% sales increase during the fourth quarter.

Consistent with our strategy to stabilize the U.S. and Canada business, e-commerce will continue to be an important source of growth more now than ever before.

While top line challenges, including a temporary issue with one of our wholesale partners, resulted in SG&A deleverage during the fourth quarter, our work to reduce cost is still very much on track. In the past year, we pulled more than \$35 million in costs out of the business, and our plan includes an additional \$25 million in expense savings by the end of 2020.



As we work through the potential impacts of the coronavirus situation, our focus on cost management will only intensify. We cannot assure you, however, that any or all of these additional expense savings will be realized. We are happy with the progress we made in stabilizing the domestic retail business in 2019. Our store optimization efforts and cost savings initiatives contributed to another quarter of year-over-year EBITDA improvement in the U.S. and Canada segment.

For the full year 2019, these initiatives drove an increase in EBITDA in the segment, which is consistent with our long-term strategy. On a consolidated basis, our quarterly adjusted EBITDA was \$26 million, down \$9 million from the fourth quarter of last year, driven by the transfer of the Nutra Manufacturing facility and China business to newly formed joint ventures.

As a reminder, in connection with these transactions, we received proceeds of approximately \$100 million for the first installment of the manufacturing joint venture and \$300 million for the issuance of convertible preferred stock to Harbin Pharmaceutical.

As you know, we've been actively pursuing opportunities to refinance our current debt with an independent committee of our Board. Although we've experienced slowing progress due to the worldwide impact from COVID-19, we continue to review a full range of options to refinance our capital structure in both the U.S. and Asia.

GNC's first priority has always been the well-being of our associates, our customers and the communities we serve. And that has never been truer than it is today. As we face the coronavirus pandemic, we're working to educate the GNC team on the best ways to take care of themselves, take care of our customers and do our part in keeping our communities healthy.

As of yesterday, we had approximately 900 stores in the U.S. and Canada that were temporarily closed for business, representing nearly 25% of the combined store base. The largest percentage of these stores are located in malls. In addition, we had nearly 700 stores operating on limited hours. This is a very fluid situation, and we review it on a daily basis. As you might expect, our e-commerce business is running substantially ahead of prior year run rate, and we're working hard to process and ship orders as quickly as possible, although we are currently experiencing some delivery delays.

Our new order management system, which launched successfully in January, will deliver buy online and pick up in store capabilities later in the year, but in the meantime, we launched curbside pickup in many of our strip centers to allow customers another convenient method to get products they need during this difficult time.

All of our distribution centers are open and operating, and we are working closely with our vendor partners to keep merchandise flowing as efficiently as possible through our supply chain.

In addition, approximately 95% of our corporate office team is now working remotely. Clearly, this unprecedented and rapidly changing situation is disrupting many businesses and many industries. And while consumers' trust in the high-quality products and expert advice that we offer has become more important than ever in this environment, it is impossible for anyone to predict the length and severity of the current crisis. As we continue to work our way through the impacts of COVID-19, I continue to be in awe of the entire GNC team. They remain focused on taking care of our customers and meeting the needs of their communities during this very difficult time.

With that, I'll turn it over to Tricia.

Tricia K. Tolivar - GNC Holdings, Inc. - Executive VP & CFO

Thanks, Ken, and good morning, everyone. Our quarterly adjusted EBITDA was \$26 million, down \$9 million from the fourth quarter of last year, driven by the transfer of the Nutra Manufacturing facility and China business to the newly formed joint ventures.

For the full year, adjusted operating income from our largest operating segment, U.S. and Canada increased \$20 million or 15% compared with 2018, driven by lower occupancy costs and lower salaries and benefits as a result of our store optimization and cost reduction initiatives. These



initiatives helped drive improvements in adjusted operating income margin of 160 basis points in this key segment from 6.7% in 2018 to 8.3% in 2019.

Fourth quarter consolidated revenue was \$470 million compared with \$548 million in the prior year. The decrease is primarily attributed to the transfer of the Nutra Manufacturing and China businesses to the newly formed joint ventures, closure of company-owned stores from our store optimization initiatives and negative same-store sales in the U.S. company-owned stores.

Fourth quarter same-store sales, including e-commerce, were down 2.4%. Breaking apart the pieces, U.S. domestic brick-and-mortar comps were down 4.9% and e-commerce was up nearly 15%. E-commerce sales increased to 11.5% of U.S. and Canada revenue in the current quarter compared with 9.3% in the prior year quarter.

As we shift the business toward a true omnichannel model, we believe a blended comp is the best way to look at the business. So going forward, we will no longer be breaking apart the pieces of our omnichannel external comp. Revenue from our international business, excluding China, was down slightly. As highlighted on prior quarters, the transfer of the China business to the joint venture resulted in a \$9 million expected decrease in revenue.

Manufacturing and wholesale revenues, excluding intersegment sales, decreased approximately \$34 million primarily due to the asset transfer to the newly formed manufacturing JV as a result of the transaction with International Vitamin Corporation on March 1, 2019. Wholesale revenues declined approximately \$6 million, largely driven by a reduction in consignment revenue with Rite Aid and a decrease in wholesale sales due to Rite Aid's focus on working capital reductions in the fourth quarter.

At the end of 2018, we renegotiated a contract with Rite Aid and eliminated the consignment portion of the prior contract, which created unique supply chain inefficiencies. As a result, the elimination of these sales does not have a material impact on profitability. In addition, we eliminated the radius restriction that prevented us from selling GNC products within a certain mile radius of Rite Aid stores. This change, which went into effect in January 2019, freed us up to explore new strategic partnerships, some of which we highlighted on the last call, DICK'S Sporting Goods, Hudson News and Albertsons.

Fourth quarter gross profit was 32.9% of sales compared with 31.5% in the prior year. The improvement was due to the transfer of the Nutra Manufacturing business to the manufacturing JV, and lower occupancy expense as a result of the adoption of the new lease accounting standard, store closures and rent reductions associated with the store portfolio optimization strategy. Additionally, as a reminder, in the fourth quarter of 2018, we had a \$2.5 million prior period correction related to specialty manufacturing in our Nutra Manufacturing facility on a \$2.5 million reserve taken for balance sheet risks related to a third-party vendor. At 29.4% of sales, fourth quarter adjusted SG&A was up 230 basis points from last year, primarily driven by deleverage in salaries and benefits associated with the decrease in sales as well as an increase in marketing and consulting fees.

SG&A dollars were down \$10 million compared to the fourth quarter of 2018 on an adjusted basis, primarily due to lower salaries and benefits associated with the store portfolio optimization and cost savings initiatives.

As Ken mentioned earlier, we delivered over \$35 million in cost savings throughout 2019.

Moving to the 2019 audit and our refinancing. As previously disclosed, our 2019 audit opinion includes a going-concern explanatory note, resulting solely from an upcoming maturity date under the tranche B2 term loan and the notes.

As we have been discussing, we are exploring several refinancing options in Asia and the United States. We have been in discussions with certain lenders in Asia with respect to refinancing options. We became aware last night by those lenders that they are no longer pursuing a refinancing with us. We will continue to explore all options to refinance and restructure our indebtedness. While we continue to work through a number of refinancing alternatives to address these maturities, we cannot make any assurances regarding the likelihood, certainty or exact timing of any alternatives.



We ended the fourth quarter with \$117 million of cash and an undrawn revolver. For the full year versus last year, free cash flow increased \$4 million from \$77 million to \$81 million. The increase was driven by a favorable working capital charges -- changes, primarily due to an increase and accounts payable as a result of the company's cash management efforts as well as the establishment of payables associated with the manufacturing joint venture. As a precautionary measure, given the current macro environment, we recently drew \$30 million on our revolver, resulting in over \$130 million in cash as of yesterday. Although we have historically taken questions at the end of each call, these are unusual times presenting many unknowns. And as such, we will not be taking questions on the call today. Please feel free to reach out to myself, Matt Milanovich, or John Mills at ICR. Thank you.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time, and thank you for your participation.

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