

November, 10, 2017

## Nutrisystem: NTRI

Connor Morelli

**Sector:** Consumer Discretionary

**Industry:** Personal Care Services

**Current Price:** \$47.35

**Target Price:** \$59.08

**Company Description:** Nutrisystem is a leading provider of weight management products and services, including nutritionally balanced weight loss programs sold primarily online and over the telephone. Multi-day kits and single items are also available at select retail locations. Nutrisystem also provides digital tools to support healthy weight loss. Nutrisystem operates in one segment, weight management systems, and through this segment customers purchase monthly food packages containing 4-week meal plans. Nutrisystem operates on an auto delivery system where meals are shipped directly to the consumer every 4-weeks until notice of cancellation. Nutrisystem currently features over 150 diversified menu items at different price points, as well as counseling options from trained weight loss counselors, registered dieticians, and certified diabetes educators at no additional cost to the customer.

### BUY

Current Price:	\$47.35
Target Price:	\$59.08
Market Cap:	1.44B
Average Volume	475,027
WACC	9.0%
ROIC	61.7%
EBITDA Margin	9.59%
Sales Growth LTM	28.1%
ROIC/WACC	6.85

### Catalysts:

**Short Term (Within the year):** Seasonality in weight loss industry results in greatest revenue during the first calendar quarter.

**Mid-Term (1- 2 years):** Channel expansion to extend customer reach. Continued ability of newly implanted South Beach Diet to broaden and on board customer base.

**Long Term (3+):** Focus on continued product and marketing innovation to drive customer acquisition and retention. Effective management of food and distribution costs.



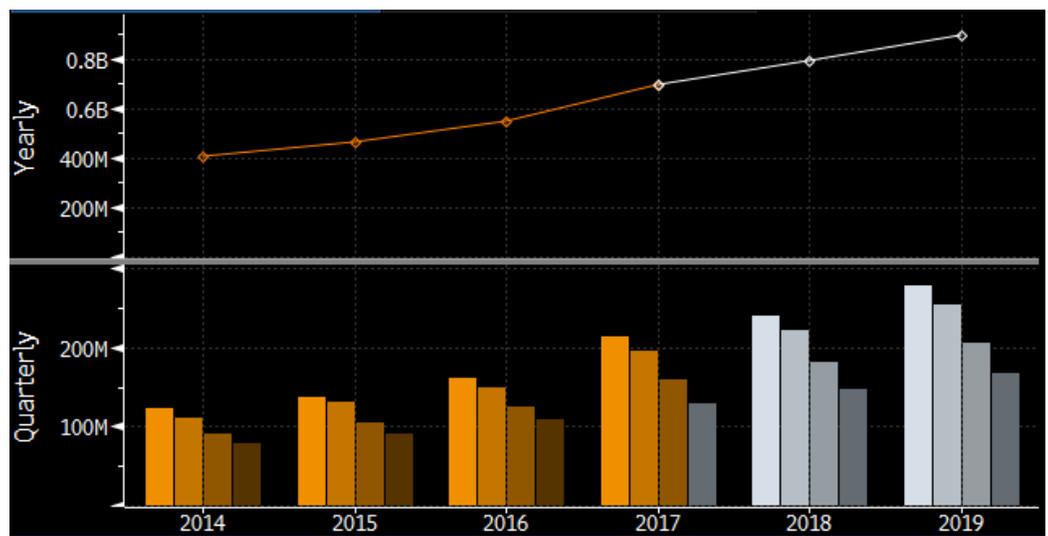
## Thesis:

Nutrisystem is poised to continue growing their top and bottom lines for at least the near to midterm. Currently there is an estimated 160 million over-weight or obese adults in the United States. The need for weight loss and weight management products is at an all-time high. Through strategic marketing initiatives to expand market share and industry leading capital allocation strategies, Nutrisystem is in a strategic position to capitalize on the obesity epidemic that America is currently facing. With the continuation of double digit revenue growth and a cost-efficient structure put in place by management, along with a proven capital allocation strategy, Nutrisystem will continue to bring value to shareholders.

## Recent Earnings Performance:

Nutrisystem recently released third quarter 2017 earnings results on October 25, 2017. For the 3Q, the company generated 27% year over year top line growth to \$158.1mm as compared to \$124.6mm the year prior. Revenue for the third quarter beat analyst estimates by \$2.94mm. The third quarter of 2017 represented the 17<sup>th</sup> consecutive quarter of year over year revenue growth for Nutrisystem, which reflects the strong demand, and customer reception for Nutrisystem’s programs and products. Gross margins increased 50 basis points to 54.2%, compared to 53.7% the prior year. Adjusted EBITDA increased 53% to \$27.7mm, compared to the previous years reported adjusted EBITDA of \$18.1mm. Marketing expenses were the main source of SG&A expenses for the quarter as the company spent \$42.1mm or 26.6% of revenue on marketing initiatives. The newly acquired and implemented South Beach Diet contributed \$5mm in revenue for the third and management stated they expect South Beach to contribute \$26mm to revenue this year. Reactivation revenue remained strong during the third quarter because of increased customer count, increased product offerings and improved reactivation yield. Nutrisystem reported \$42mm of reactivation revenue for the quarter, up 30% year over year. As a result, net income for the third quarter grew 89% to \$15mm, compared to \$7.9mm the previous year. During the earnings, call management also raised fourth quarter and full year guidance, signaling continued confidence in the business. Fourth quarter revenue is expected to be in the range of \$126-131mm and net income between \$11.4-12.7mm and adjusted EBITDA between \$23.7-25.7mm. The fourth quarter of Nutrisystem’s business cycle is typically one of the weaker quarter for revenue generation. Full year revenue guidance for FY 2017 was raised by management and is expected to be in the range of \$692-697mm compared to the previous range of \$684-694mm. Bottom line guidance was also raised by management and is expected to fall \$58.3-59.7mm compared to the previous range of \$56.1-59.0mm.

The figure to the right shows the revenue growth for Nutrisystem on an annual and quarterly basis.



## Weight Loss Industry Outlook:

Nutrisystem operates in the consumer discretionary sector and demand for weight loss services is dependent on changes in per capital disposable income. During economic recessions, consumers typically cut back on their discretionary spending and utilize independent, cheaper programs or methods. Overall consumer discretionary trends translate to the weight loss industry’s ability to generate revenues and profits. The outlook for the consumer discretionary sector is promising. The September retail sales report from the Census Bureau showed a 1.6% gain in sales month over month. Average hourly earnings have risen 2.5% percent over the last 12 months according to the BLS. The overall global market for weight loss and management services is valued at \$165B while Nutrisystem sees an addressable market opportunity for weight loss products domestically at \$10-15B. The global weight loss and diet management market is poised to grow at a CAGR of 7.1% over the next decade is expected to reach \$285.9B by 2024. I believe this CAGR estimate to be in line with industry trends as we see improving wage growth, accommodative monetary policy, and wage growth leading to increased consumer spending. This growth estimate also takes into account the expanding opportunities in emerging markets, which I believe Nutrisystem will have the ability to capture in the future and increasing obesity rates around the globe attributed to an increasingly sedentary lifestyle. Over 160M adults in the United States alone are considered overweight and at any one time, over 85M are actively trying to lose weight. This statistic represents an increasing market share Nutrisystem can market to and capitalize on. As the number of obese and overweight individuals has steadily inclined, this trend has supported stable need-based demand for industry services. In my opinion, I believe the obesity epidemic in the United States and around the world to continue to be an issue for decades to come, resulting in increased need for weight loss and management services. About 80% of people try to lose weight independently and a growing number of these individuals fail in their weight loss efforts, this has resulted in increasing revenues and earnings for companies in this space. In 2016 weight loss companies, generated revenues of \$6.3B, primarily because of increased home deliveries. As home delivery programs continue to expand options and plans, companies such as Nutrisystem are poised to capture market share, improve delivery efficiencies and costs, and accommodate consumer preferences.



## Nutrisystem Growth Strategy:

Since hiring of CEO Dawn Zier in late 2012, Nutrisystem has returned to profitability very quickly and is well positioned to create significant value in the next 3-5 years. The primary goal of management to create value for shareholders is to continue to capture market share in the weight loss and weight management industry, while keeping operating costs steady. In July of 2017, management outlined a three-pronged growth strategy for Nutrisystem. By investing in their brands, investing in product innovation, and expanding across multiple consumer channels, management hopes to continue market share, therefore increasing revenues and earnings, while keeping costs at a minimum. In December 2015 Nutrisystem acquired the South Beach Diet brand and has since developed products, programs, and infrastructure to support the launch of this product in January 2017. Management expects the South Beach Diet to contribute \$26mm in revenue for FY 2017. I expect marketing initiatives taken by Nutrisystem to continue to drive consumer awareness for the South Beach Diet product and I believe there is a relatively untapped market for Nutrisystem to penetrate. The South Beach Diet incorporates trends in today's health conscious environment by offering plans that feature low sugar, low carb, and high protein meals. I believe in the next 3-5 years we should see the South Beach Diet become a sizable portion of revenue generation for Nutrisystem in the area of 15-20% of total revenue. Currently the South Beach Diet makes up about 4% of the revenue generated by Nutrisystem. The South Beach Diet should allow Nutrisystem to grab market share from competitors such as Weight Watchers and Medifast, which offers Jenny Craig.

Another strategy to drive revenue growth is to continue to expand consumer channels and brands by investing in marketing and ecommerce initiatives. The direct to consumer pipeline, where products are shipped directly to customer homes, makes up the majority of revenue Nutrisystem. To capture market share, Nutrisystem must invest heavily in marketing their brand. Nutrisystem markets over a variety of mediums such as television, internet, direct mail, print and radio. Nutrisystem also supplements their marketing plan with ecommerce and data analytics to accelerate growth. Currently the company spends \$42.22mm or 26.6% of their revenue on marketing expenses. I believe this percentage of revenues to remain constant over the near to mid-term as Nutrisystem has been consistently taking market share from Weight Watchers. Currently, Weight Watchers commands 28% of the market with Nutrisystem making strides in the last 4 years to close the gap to 27.3%. This shows that Nutrisystem's marketing initiatives have been successful in capturing market share from Weight Watchers. To expand the consumer channel, to reach a broader customer base, Nutrisystem has begun to sell their products in retail environments such as Walmart, Kroger, and Publix. The goal of Nutrisystem's expansion into the retail space is not to drive revenue growth through sales but to raise brand awareness and provide trials for potential customers who will then purchase plans through the auto delivery system, providing the customer with cyclical revenue sources. With Nutrisystem currently expanding market share, while keeping costs stable as seen in the improvement in gross margins for the past two years, Nutrisystem should continue to see improvement in EBITDA margins to 12-14% over the next two years and continue to see double digit revenue growth for the near future due to overall improvement in operating performance. This is in line with current analyst estimates.

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## Company Performance and Cross Sectional Analysis:

Name	Sales Growth (%)	EBITDA Growth	EBITDA Margin	Operating Income Margin	Net Income Growth (%)	Capex/Sales (%)	Return on Invested Capital	WACC	LT Brrwng
Median	9.08%	33.83%	14.39%	12.85%	73.29%	1.05%	24.00%	11.10%	0.00
100) NUTRISYSTEM INC	28.08%	59.55%	14.03%	11.83%	73.29%	2.71%	50.50%	11.10%	0.00
101) WEIGHT WATCHERS INTL ...	9.08%	33.83%	25.14%	21.03%	114.78%	0.48%	24.00%	11.22%	1.88B
102) MEDIFAST INC	4.63%	5.73%	14.39%	12.85%	8.91%	1.05%	23.58%	7.51%	0.00

Nutrisystem has shown improving fundamentals, primarily in sales growth and EBITDA growth over the LTM period. Nutrisystem also has significant working capital in which they are able to fund and invest in business operations. For the LTM sales growth has grown 28.08% while EBITDA has grown 59.55% over the LTM. This shows that Nutrisystem's strategy of cost control is working effectively and the company is currently creating value. The revenue of generation of Nutrisystem and other weight loss management providers is highly seasonal, as seen in the past quarterly revenue reports and forward looking quarterly revenue estimates. The first quarter of the calendar usually sees the highest volume of sales, leading to the most profitable quarter. This is due to the psychological tendencies of consumers to begin new diets and other health conscious resolutions at the turn of the new year. GAAP net income growth was 73.29% over the last twelve months, while EBITDA margin was 14.39%. With the implementation of the low-cost South Beach Diet brand added to Nutrisystem's portfolio of brands, margins should continue to expand as top line growth continues. Current valuation multiples for Nutrisystem also compare favorably to their main competitor's, Weight Watchers. The current price to earnings ratio for Nutrisystem is 25.65 and is expected to decline in the next three years according to analyst estimates. Weight Watchers current price to earnings ratio is 30.82 which gives us reason to believe Nutrisystem is slightly undervalued in this market. The same can be said for the EV/EBITDA ratio. The EV/EBITDA ratio for Nutrisystem is currently 14.12 and compared to the EV/EBITDA value for Weight Watchers, which is 14.90, shows Nutrisystem being slightly undervalued by the market. Among Nutrisystem's competitors, they currently have the highest revenue growth, EBITDA growth, and strong net income growth. Sales grew 3x greater than Weight Watchers over the LTM, while EBITDA growth has also surpassed Weight Watchers. CAPEX/Sales was reported at 2.71% for Nutrisystem over the LTM, while Weight Watchers had significantly lower CAPEX/Sales at 0.48%, this shows that Nutrisystem is confident in their business model and are comfortable reinvesting cash flows into productive, capital assets, such as two new food processing plants that were opened in the past year. These CAPEX are justified by a cash basis adjusted ROIC of 61.7%.

## Ownership Summary:

Rank	Company	Asset Class	Shares	% of Float	Change (Shares)	Change (%)
1	BLACKROCK	ULT-AGG	3,498,827	11.65	-55,395	06/30/17
2	VANGUARD GROUP	ULT-AGG	2,458,890	8.19	823,221	09/30/17
3	RENAISSANCE TECHNOLOGI...	RENAISSANCE TECHN...	2,414,100	8.04	-73,800	06/30/17
4	EAGLE ASSET MANAGEMENT...	EAGLE ASSET MANAGE...	1,937,466	6.45	-70,694	06/30/17
5	PRUDENTIAL FINANCIAL INC	ULT-AGG	1,291,126	4.30	-169,640	09/30/17
6	EMERALD ADVISERS, INC	ULT-AGG	1,201,029	4.00	135,760	09/30/17
7	DIMENSIONAL FUND ADVIS...	DIMENSIONAL FUND A...	1,105,785	3.68	5,597	06/30/17
8	ACADIAN ASSET MANAGEME...	ACADIAN ASSET MANA...	1,092,386	3.64	102,623	09/30/17
9	STATE STREET CORP	ULT-AGG	846,058	2.82	81,175	06/30/17
10	THRIVENT FINANCIAL FOR ...	THRIVENT FINANCIAL...	759,853	2.53	14,672	06/30/17
11	TIAA-CREF	ULT-AGG	749,466	2.49	56,411	06/30/17
12	FMR LLC	ULT-AGG	719,379	2.39	-6,380	06/30/17
13	ARROWSTREET CAP LIMITE...	ARROWSTREET CAPIT...	698,034	2.32	101,514	06/30/17
14	DEUTSCHE BANK AG	ULT-AGG	510,175	1.70	375,991	06/30/17
15	BNY MELLON	ULT-AGG	494,790	1.65	-13,261	09/30/17
16	COPPER ROCK CAPITAL PA...	COPPER ROCK CAPIT...	476,682	1.59	-211,001	09/30/17
17	RUSSELL INVESTMENTS GR...	RUSSELL INVESTMENT...	446,774	1.49	26,351	09/30/17
18	NORTHERN TRUST CORPOR...	NORTHERN TRUST CO...	425,972	1.42	-4,787	06/30/17
19	WELLS FARGO & COMPANY	ULT-AGG	425,776	1.42	67,151	09/30/17

Ownership Type	08/06/17	Curr ↓	Change
Investment Advisor	72.78	74.46	+1.68
Hedge Fund Manager	19.10	18.17	-0.93
Pension Fund	3.26	2.95	-0.31
Individual	1.76	1.36	-0.40
Bank	1.23	1.20	-0.03
Insurance Company	1.06	1.13	+0.07
Government	0.25	0.22	-0.03
Brokerage	0.20	0.11	-0.09
Family Office/Trust	0.10	0.08	-0.02
Venture Capital	0.10	0.08	-0.02
Foundation	0.08	0.07	-0.01

The majority holders of Nutrisystem consist of primarily Investment Advisors and Hedge Fund Managers. Over the last three months Invest Advisors have increased their positions in Nutrisystem by 1.68% while hedge funds have primarily exited their positions at a clip of 0.93%. I believe the majority reason for the decline in ownership by hedge funds was profit seeking in nature and not necessarily as a result of weakened outlook of fundamentals. The percentage of ownership by hedge funds is currently 18.17% of float which signals hedge funds are still confident in the growth prospects of the company. The primary holders of Nutrisystem that are Investment Advisors are asset management firms Blackrock and Vanguard. Vanguard recently bought into 823,221 shares at the end of September, which in my opinion confirms the confidence many asset managers have in the company's performance. What is concerning to me is the amount of short interest there is in Nutrisystem. Currently the percentage of float out that has been initiated into a short position is approximately 14%. While that number is higher than is typically desired, the short interest for Nutrisystem is lower than their closest competitors. Executive compensation, however, is tied into stock price. By making sure stock performance and returning value to shareholders is the majority of the compensation earned by company executives, this signals to a resolution of potential agency problems the company may face very quickly.

## Capital Allocation Comparison:

Nutrisystem operates their business 100% debt free and finances operations using free cash flows. Over the LTM, the Return on Invested Capital (ROIC) for Nutrisystem is 61.7%, while historically the company has generated returns of 30.3% on their capital investments. This shows that management is extremely effective at capital allocation. This claim is further supported by a ROIC/WACC ratio of 6.85, which shows that value is being created and at a greater rate than their historical ROIC/WACC ratio of 3.48. The ROIC and ROIC/WACC ratio of Nutrisystem are significantly higher than the rest of their competition. For example, Nutrisystem's biggest competitor, Weight Watchers, over the LTM has reported an ROIC of 21.6% and a ROIC/WACC ratio of 2.45. What is significant about these figures is that over the LTM Weight Watchers has actually deviated lower from their historical averages, while Nutrisystem has improved upon these measures. This is further evidence that Nutrisystem leads this space in capital allocation strategy. Nutrisystem also operates their business free of debt and holds various short-term cash investments. In December 2015,

Nutrisystem acquired the South Beach Diet brand for \$15mm in short term cash equivalents. On October 25 of this year, Nutrisystem’s board authorized a stock buyback program, which authorizes the company to buyback \$50.00mm in outstanding shares once the previous stock buyback initiative expires in November of 2017. The company will buy back stock through open market transactions. In my opinion, the confidence in management to initiate a stock buyback program immediately after the expiration of previous programs leads me to believe that management strongly believes shares are undervalued in the open market.

ROIC (NOPAT/IC)		
	<i>History</i>	<i>LTM</i>
NTRI	30.3%	61.7%
Competitors	6.2%	-7.8%
<b>Target</b>	<b>61.7%</b>	

ROIC /WACC		
	<i>History</i>	<i>LTM</i>
NTRI	3.48	6.85
Competitors	1.65	(0.54)
<b>Target</b>	<b>6.85</b>	

Capital Usage (Rev/IC)		
	<i>History</i>	<i>LTM</i>
NTRI	7.81	8.43
Competitors	3.39	5.24
<b>Target</b>	<b>8.43</b>	

## Conclusion:

In conclusion, I believe the recent price dip in Nutrisystem warrants a buying opportunity at a target price of \$59.08. Nutrisystem has shown the ability to adopt to ever-changing market trends, while continuing to grow their top and bottom lines and managing costs effectively. The American obesity epidemic has shown no signs of correcting itself so there will be a need for weight loss and weight management products for the foreseeable future. With new product innovation and marketing strategies in place, Nutrisystem is poised to continue expanding its market share in the weight loss industry all the while keeping costs steady as revenue increases, double digit return can be expected within the next one to two years.

# Nutrisystem, Inc. (NTRI)

## CENTER FOR GLOBAL FINANCIAL STUDIES

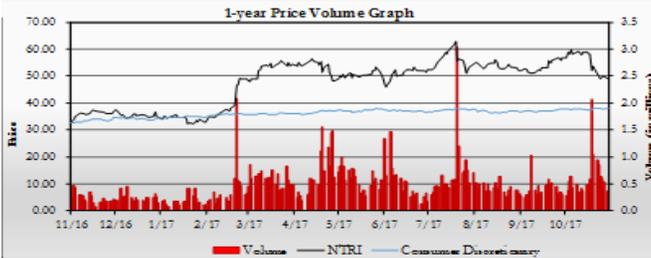
**BULLISH**

Analysis by Connor Morelli  
11/9/2017

Current Price: \$47.95  
Dividend Yield: 1.8%

Intrinsic Value: \$54.48  
Target Price: \$59.08

Target 1 year Return: 25.02%  
Probability of Price Increase: 98.33%

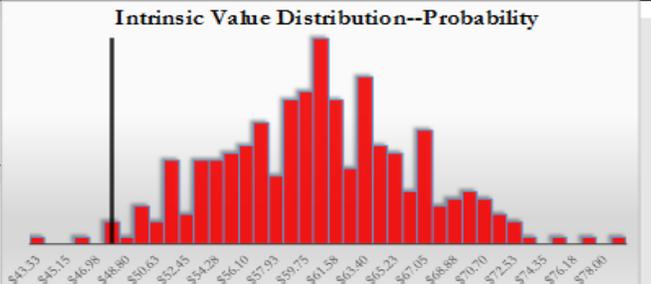


<b>Description</b>	
Nutrisystem, Inc., together with its subsidiaries, provides weight management products and services for women and men in the United States.	
<b>General Information</b>	
Sector	Consumer Discretionary
Industry	Internet and Direct Marketing Retail
Last Guidance	November 3, 2015
Next earnings date	February 26, 2018
Estimated Country Risk Premium	5.13%
Effective Tax rate	24%
Effective Operating Tax rate	24%

<b>Market Data</b>	
Market Capitalization	\$1,429.05
Daily volume (mil)	0.65
Shares outstanding (mil)	29.80
Diluted shares outstanding (mil)	30.07
% shares held by institutions	116%
% shares held by investment Managers	87%
% shares held by hedge funds	18%
% shares held by insiders	1.30%
Short interest	14.78%
Days to cover short interest	9.25
52 week high	\$67.95
52-week low	\$30.11
Volatility	38.58%

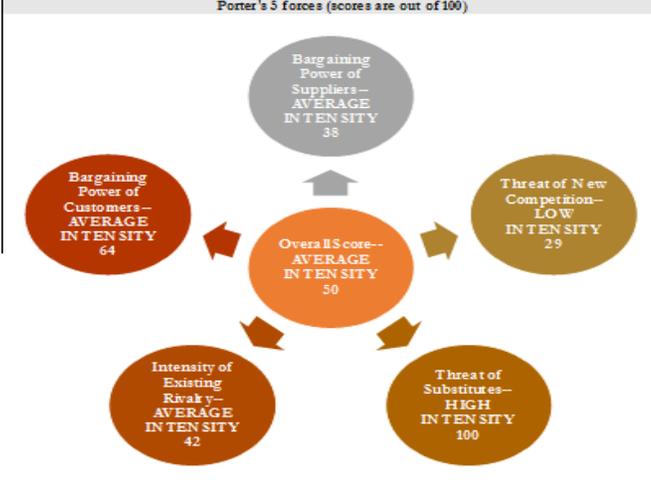
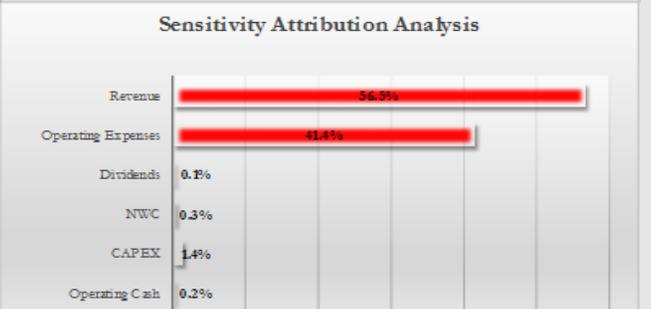
<b>Past Earning Surprises</b>		
Quarter ending	Revenue	EBITDA
9/30/2016	7.01%	-0.17%
12/31/2016	8.64%	20.21%
3/31/2017	4.33%	2.97%
6/30/2017	8.39%	13.27%
9/30/2017	1.56%	-3.98%
Mean	5.99%	6.06%
Standard error	1.3%	4.7%

<b>Peers</b>	
Weight Watchers International, Inc.	
Blue Apron Holdings, Inc.	
PeMed Express, Inc.	
FTD Companies, Inc.	
1-800-FLOWERS.COM, Inc.	



<b>Management</b>		<b>Position</b>		<b>Total compensations growth</b>		<b>Total return to shareholders</b>	
Zier, Dawn	Chief Executive Officer, Pre	30.62%	per annum over 3y	35.52%	per annum over 3y		
Monahan, Michael	Chief Financial Officer and	-2.61%	per annum over 2y	18.64%	per annum over 2y		
Krausz, Kara	Chief Marketing Officer and	-14.05%	per annum over 2y	18.64%	per annum over 2y		
Mauro, Ralph	Senior Vice President, Gen	N/M		N/M			
Shallow, Robin	Vice President of Communicat	N/M		N/M			
	0.0	N/M		N/M			

<b>Profitability</b>		<b>Invested Funds</b>	
Return on Capital (GAAP)	NTRI (LTM)	Cash/ Capital	NTRI (LTM)
61.7%	61.7%	22.7%	32.3%
Operating Margin	7%	NWC/ Capital	9.3%
Revenue/ Capital (GAAP)	8.43	Operating Assets/ Capital	67.8%
ROE (GAAP)	76.5%	Goodwill/ Capital	0.0%
Net margin	9.1%	<b>Capital Structure</b>	
Revenue/ Book Value (GAAP)	8.36	Total Debt/Market Capitalization	0.07
		Cost of Existing Debt	3.3%
		CGFS Rating (F-score, Z-score, and default Probability)	AA
		WACC	8.4%



<b>Period</b>		<b>Revenue Growth Forecast</b>	
Base Year	28%	NOPAT Margin Forecast	
9/30/2018	18%	10.3%	7.85
9/30/2019	14%	12.6%	5.25
9/30/2020	3%	13.0%	3.93
9/30/2021	3%	13.0%	2.91
9/30/2022	3%	12.6%	2.35
9/30/2023	3%	12.9%	2.00
9/30/2024	3%	12.6%	1.75
9/30/2025	4%	12.3%	1.58
9/30/2026	4%	11.9%	1.45
9/30/2027	4%	11.6%	1.36
Continuing Period	4%	11.3%	1.30
		11.0%	1.25

<b>Period</b>		<b>Return on Capital Forecast</b>		<b>WACC Forecast</b>		<b>Price per share Forecast</b>	
Base Year	82.3%	8.4%	\$55.00				
9/30/2018	63.9%	8.8%	\$59.66				
9/30/2019	51.0%	8.8%	\$63.61				
9/30/2020	37.7%	9.0%	\$67.66				
9/30/2021	29.6%	9.2%	\$71.86				
9/30/2022	25.8%	9.5%	\$76.22				
9/30/2023	22.0%	9.6%	\$80.62				
9/30/2024	19.3%	9.6%	\$85.08				
9/30/2025	17.3%	9.7%	\$89.60				
9/30/2026	15.8%	9.7%	\$94.19				
9/30/2027	14.6%	9.7%	\$98.88				
Continuing Period	13.7%	9.7%					