

Nutrisystem, Inc.

Nasdaq: NTRI



Adding another monster retailer, reiterate Strong Buy

27% Total Upside to Our Price Target: We believe consensus expectations will rise to our High-on-the-Street estimate of \$0.96 for 2016 (3% above consensus). As growth accelerates, we expect the stock to be rewarded with a higher multiple which is key to our \$21.16 one-year price target (derived from 24x, 10% above the company's average multiple for the past 10 years, our 4Q15 & 1Q/2Q/3Q16 EPS forecast of \$0.92).

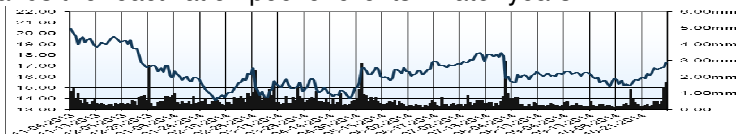
Where we differ from consensus: We are above market expectations in terms of 1) NTRI's ability to add new customers; 2) NTRI's potential to expand its 5 Day Weight Loss Kit and other innovative products to more retail channels; and 3) NTRI's ability to improve its marketing efficiency. We are slightly increasing our 4Q14 estimates to \$0.18 EPS (5% above consensus) as pricing increases and promotional decreases were ahead of our expectations. We are reducing our revenue estimate to \$85M from \$89M (6% above consensus) as our retail growth expectations were too early (Target corp.) and QVC revenues were off in timing. We revise downward our 2015 EPS estimate slightly to \$0.80 (inline with consensus), which is 18% YoY growth vs. our 2014 estimates. The EPS growth is driven by \$451M revenue (3% above consensus and 14% YoY growth over our 2014 estimates) and net margin improvement of 20bps to 5.1%. See below for 2016 estimates.

3Q14 Forward Looking Takeaways:

Retail has potential to increase 50+% to \$40M in 2015 from \$25M in 2014 as new products at Wal-Mart, successful sales at Sam's Club (600 stores), and a potential roll-out at Target or another food/drug retailer could drive results. However, if management becomes more selective on where it distributes to retail venues, this limits expansion opportunity and most retail upside will occur in 2015.

Gross margin (adj.) improvement is encouraging: 51.4% vs. 50.1% prior year as it demonstrates NTRI's proposition and ability to increase prices without a decline in customer traffic. We view that gross margins still have more upside (30-50 bps), as our 2015/16 estimates are 51.0% and 51.2%, respectively.

New customer growth of 13+% YoY for 3Q14. New customer growth is paramount to the long-term health of the business as it expands the reactivation pool of clients in later years.



Rating	Strong Buy
Risk Rating	Moderate
Current Price (Nov 4, 2014)	\$17.34
12 month price target	\$22.08
Implied dividend yield	4%
Projected total return	27%

Shares outstanding (M)	28.8
Market capitalization (M)	\$499.3
Long term debt (MRQ)	\$0.0
Cash (MRQ)	\$38.5
NTM P/E	24.0x
NTM EPS (4Q15-3Q16)	\$0.92

Average daily volume (3 m)	340,000
Float as % of shares out.	93%
Short interest as % of Float	16%
Insider ownership	2%
Institutional ownership	81%

Tangible book value p/s	\$1.90
Cash/share	\$1.34

Revenue (M)				
	2013	2014E	2015E	2016E
Q1	\$105.4	\$122.2	\$135.2	\$149.9
Q2	\$97.5	\$111.1	\$116.6	\$129.9
Q3	\$85.4	\$90.6	\$102.9	\$105.0
Q4	\$69.9	\$85.0e	\$96.2	\$101.8
FY	\$358.1	\$408.8	\$450.9	\$486.6
EPS Adj. for extra items				
	2013	2014E	2015E	2016E
Q1	(\$0.02)	\$0.01	\$0.06	\$0.14
Q2	\$0.22	\$0.31	\$0.26	\$0.31
Q3	\$0.01	\$0.17	\$0.23	\$0.25
Q4	\$0.05	\$0.20	\$0.24	\$0.28
FY	\$0.26	\$0.69	\$0.78	\$0.97

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Why are we bullish on retail?:

Nutrisystem is expanding the company's online retail with the announced test of selling popular Nutrisystem products at Amazon. This entails Nutrisystem starting a store on Amazon. Nutrisystem will be testing this later in November but the real launch is scheduled for January 2015. The products to be sold through Amazon will not replicate the 28-day fundamental Nutrisystem program but are likely to be smaller packages and one-off items. This could even include some cross-selling of non-food items, but probably related to food.

We suspect that the stock price increase (3% after 11/04 close) was due to a combination of factors:

- 1) NTRI outperformed albeit lowered expectations from a less impressive 3Q14 results.
- 2) Retail potential remains strong with incremental products at Wal-Mart (that tested well), Target still remains a possibility, and now Amazon's test in 1Q15.

Offset by..

- 1) Length of stay declined four days, however management stated that it expects trends to improve because of the new pricing strategy, NuMi, and the elimination of one free week in the program
- 2) Mixed announcements about target and management stating that it has less potential to be a driver

What catalysts may occur (near-term catalysts toward the top):

- 1) Announce an expansion of the 5 Day Weight Loss Kit into more Target stores.
- 2) Simply Fresh test goes well and adds an incremental customer
- 3) Amazon test is favorable
- 4) Expand the direct sales business to the market in Mexico (Medifast recently moved to this market).
- 5) Add incremental marketing programs focused on African Americans, Hispanics, and/or overweight children.
- 6) Announce an expansion test for another drug retailer (Walgreens/CVS).

Risks to our thesis:

- 1) Retail may disappoint and contribute less during 2015/16.
- 2) Marketing efficiency may not improve as a result of ineffective campaigns during 2015/16.
- 3) Product innovation may be less effective
- 4) Competition from natural/organic diet-related foods delivery services
- 5) Increase in the number of dieters who diet without a structured food program (do-it-yourself dieter)
- 6) Length of stay may continue to decline

Appendix A: Income Statement

INCOME STATEMENT	1Q13A	2Q13A	3Q13A	4Q13A	1Q14A	2Q14A	3Q14A	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E	2010	2011	2012	2013	2014E	2015E	2016E
	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
Revenues	105.4	97.5	85.4	69.9	122.2	111.1	90.6	85.0	135.2	116.6	102.9	96.2	149.9	129.9	105.0	101.8	509.5	401.3	396.9	358.1	408.8	450.9	486.6
COGS	52.4	47.7	47.6	36.5	62.4	54.1	44.0	40.8	68.2	57.6	49.8	45.6	75.0	63.6	50.8	48.3	224.8	198.4	213.1	184.2	201.4	221.1	237.7
Gross Profit	53.0	49.8	37.8	33.4	59.8	56.9	46.6	44.2	67.1	59.0	53.1	50.6	75.0	66.2	54.2	53.6	284.7	202.9	183.8	173.9	207.5	229.8	248.9
GA	13.9	13.4	14.3	15.3	15.9	15.8	14.8	14.4	17.8	16.0	16.5	16.4	19.7	17.8	16.8	17.3	73.9	60.8	60.6	95.8	60.9	66.6	71.6
Marketing	36.3	24.3	20.0	15.2	41.7	26.0	22.4	19.5	44.0	29.0	24.0	21.5	46.0	32.0	24.0	21.5	145.9	110.9	111.1	58.2	109.6	118.5	123.5
EBITDA	2.9	12.2	3.4	2.8	2.1	15.2	9.4	10.2	5.3	14.0	12.6	12.8	9.3	16.4	13.4	14.7	65.0	31.2	12.1	19.9	36.9	44.7	53.8
Depreciation	2.5	2.3	1.9	2.1	1.8	1.9	2.1	2.0	2.6	2.2	2.0	1.8	3.0	2.6	2.1	2.0	11.8	12.1	10.7	8.9	7.7	8.6	9.7
Amortization of intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	0.3	9.8	1.5	0.7	0.4	13.2	7.3	8.3	2.7	11.8	10.7	10.9	6.3	13.8	11.3	12.7	53.2	19.1	1.3	11.0	29.2	36.1	44.1
Non-oper expenses	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Gain (loss) on asset sales	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0	(0.1)	0.0	0.0	0.0
Interest expense	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0	0.4	2.1	0.0	0.1	1.1	1.1
EBT	(1.2)	9.8	1.5	0.8	0.4	13.2	7.3	8.2	2.5	11.5	10.4	10.7	6.0	13.6	11.0	12.4	53.2	18.8	(0.8)	10.9	29.1	35.0	43.0
Provision for taxes	(0.5)	3.4	1.1	(0.5)	0.1	4.5	2.2	2.6	0.9	4.0	3.6	3.7	2.1	4.7	3.9	4.3	19.3	6.4	(3.7)	3.5	9.4	12.3	15.0
Equity earnings in affiliates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interest in earnings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.1)	0.0	0.0	0.0	0.0	0.0
Net Income (including extra)	(0.7)	6.4	0.4	1.3	0.3	8.7	5.1	5.6	1.6	7.5	6.8	6.9	3.9	8.8	7.2	8.1	33.9	12.5	2.9	7.4	19.7	22.8	27.9
WACSO	27.8	27.9	28.0	28.0	28.1	28.2	28.3	28.7	28.9	29.0	29.2	29.2	28.8	28.8	28.8	28.8	28.3	27.0	27.5	28.0	28.7	29.2	29.2
EPS (Basic Including extra items)	(\$0.02)	\$0.23	\$0.02	\$0.05	\$0.01	\$0.31	\$0.18	\$0.20	\$0.06	\$0.26	\$0.23	\$0.24	\$0.14	\$0.31	\$0.25	\$0.28	\$1.13	\$0.44	\$0.11	\$0.26	\$0.69	\$0.78	\$0.96
EPS (Basic Excluding extra items)	\$0.01	\$0.23	\$0.03	\$0.05	\$0.01	\$0.31	\$0.18	\$0.20	\$0.06	\$0.26	\$0.23	\$0.24	\$0.14	\$0.31	\$0.25	\$0.28	\$1.14	\$0.44	\$0.49	\$0.26	\$0.69	\$0.78	\$0.96
Margin Analysis																							
Gross Margin	50.3%	51.0%	44.2%	47.7%	48.9%	51.2%	51.4%	52.0%	49.6%	50.6%	51.6%	52.6%	50.0%	51.0%	51.6%	52.6%	55.9%	50.6%	46.3%	48.6%	50.7%	51.0%	51.2%
EBITDA Margin	2.7%	12.5%	4.0%	4.1%	1.8%	13.6%	10.4%	12.0%	3.9%	12.0%	12.3%	13.3%	6.2%	12.7%	12.7%	14.5%	12.8%	7.8%	3.0%	5.5%	9.0%	9.9%	11.1%
EBIT Margin	0.3%	10.1%	1.8%	1.1%	0.3%	11.9%	8.1%	9.7%	2.0%	10.1%	10.4%	11.4%	4.2%	10.7%	10.7%	12.5%	10.4%	4.8%	0.3%	3.1%	7.2%	8.0%	9.1%
Net Margin	-0.6%	6.6%	0.5%	1.9%	0.2%	7.8%	5.6%	6.6%	1.2%	6.4%	6.6%	7.2%	2.6%	6.8%	6.8%	7.9%	6.7%	3.1%	0.7%	2.1%	4.8%	5.0%	5.7%

Source: Company Reports, Midtown Partners LLC Estimates

Appendix B: Variance Analysis

INCOME STATEMENT	Reported (2Q13 vs. 2Q14)									MP Estimates				Consensus			
	3Q12A Sep-12	3Q13A Sep-13	3Q14A Sep-14	3Q13A Sep-13	3Q14A Sep-13	Variance Absolute	Variance Percent	% change Y/Y	3Q14E Sep-13	3Q14A Sep-13	Variance Absolute	Variance Percent	3Q14E Sep-13	3Q14A Sep-13	Variance Absolute	Variance Percent	
Revenue	100.0%	100.0%	100.0%	85.4	90.6	5.2	6%	6%	89.4	90.6	1.2	1%	89.4	90.6	1.2	1%	
COGS	53.9%	55.8%	48.6%	47.6	44.0	(3.6)	(8%)	(7%)	43.5	44.0	0.5	1%	43.5	44.0	0.6	1%	
Gross Profit	46.1%	44.2%	51.4%	37.8	46.6	8.8	19%	23%	45.9	46.6	0.6	1%	46.0	46.6	0.6	1%	
Gross Margin %				44.2	51.4				51.4	51.4			51.4	51.4			
G&A	18.2%	16.8%	16.3%	14.3	14.8	0.4	3%	3%	14.3	14.8	0.5	3%	17.4	14.8	(2.6)	(18%)	
Marketing	22.4%	23.4%	24.7%	20.0	22.4	2.4	11%	12%	22.0	22.4	0.4	2%	19.0	22.4	3.4	15%	
EBITDA	5.5%	4.0%	10.4%	3.4	9.4	6.0	63%		9.6	9.4	(0.2)	(2%)	9.6	9.4	(0.2)	(2%)	
EBITDA Margin %				4.0	10.4				10.7	10.4			13.1	10.4			
D&A	3.2%	2.2%	1.7%	1.9	2.1	0.2	8%	9%	2.3	2.1	(0.2)	(12%)	2.6	2.1	(0.5)	(25%)	
EBIT	2.4%	1.8%	8.7%	1.5	7.3	5.8	79%	379%	7.3	7.3	0.0	1%	7.0	7.3	0.4	5%	
EBIT Margin %				1.8	8.1				8.1	8.1			7.8	8.1			
Other Expense	0.0%	0.0%	0.0%	0.0	0.0	0.0	NA	NA	0.0	0.0	0.0	NA	0.0	0.0	0.0	NA	
Interest Expense, Net	24.4%	0.4%	4.7%	0.0	0.0	0.0	91%	1046%	0.1	0.0	(0.0)	(6%)	0.0	0.0	0.0	0%	
EBT	-22.0%	1.4%	4.0%	1.5	7.3	5.8	79%	377%	7.2	7.3	0.0	1%	6.9	7.3	0.4	5%	
EBT Margin %				1.8	8.0				8.1	8.0			7.7	8.0			
Income Tax (benefit) expense	-1.1%	1.3%	4.0%	1.1	2.2	1.1	49%	98%	2.3	2.2	(0.1)	(6%)	2.3	2.2	(0.1)	(6%)	
Net Income	-20.9%	0.1%	-0.1%	0.4	5.1	4.7	92%	1100%	4.9	5.1	0.2	4%	4.6	5.1	0.5	10%	
Basic				28.0	28.3	0.3	1%	1%	28.8	28.3	(0.5)	(2%)	28.3	28.3	0.0	0%	
Diluted				27.7	28.6	0.9	3%	3%	28.6	28.6	0.0	0%	27.7	28.6	0.9	3%	
Basic Income per common share				\$0.02	\$0.18	\$0.17	92%	1088%	\$0.17	\$0.18	\$0.01	5%	\$0.16	\$0.18	\$0.02	10%	
Diluted Income per common share				\$0.02	\$0.18	\$0.16	91%	1061%	\$0.17	\$0.18	\$0.01	4%	\$0.17	\$0.18	\$0.01	7%	
Margin Analysis																	
Gross Margin				44.2%	51.4%	715 bps			51.4%	51.4%	4 bps		50.8%	51.4%	63 bps		
EBITDA Margin				4.0%	10.4%	634 bps			10.7%	10.4%	-37 bps		13.1%	10.4%	-274 bps		
EBIT Margin				1.8%	8.1%	629 bps			8.1%	8.1%	-6 bps		11.2%	8.1%	-309 bps		
Net Margin				0.5%	5.6%	513 bps			5.5%	5.6%	13 bps		7.3%	5.6%	-169 bps		

Source: Company Reports, Midtown Partners LLC Estimates

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Rating	Rating Description	Number of Companies Covered	Midtown Partners & Co. LLC Rating Distribution Percentage	Investment Banking Clients	Percent Banking Clients
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Neutral	We expect these shares to remain within a range +/- 10% within the next 12 months	7	44%	0	0%
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Not Rated	The ratings for the subject company have been temporarily suspended by Midtown Partners & Co. LLC				

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High	Financial results of companies with a "High" risk rating have a low level of predictability and / or their share prices are subject to high volatility as measured by Beta.
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