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Dutch Bros, Inc. (BROS) Q2 2024 Earnings Call Transcript

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EPS of \$0.19 **beats by \$0.06** | Revenue of \$324.92M (30.03% Y/Y) **beats by \$7.55M**Dutch Bros, Inc. (NYSE:[BROS](#)) Q2 2024 Earnings Conference Call August 7, 2024 5:00 PM ET

Company Participants

Paddy Warren - Senior Director, IR and Capital Markets

Christine Barone - President and CEO

Josh Guenser - CFO

Conference Call Participants

Sharon Zackfia - William Blair
Andrew Charles - TD Cowen
John Ivankoe - JPMorgan
David Tarantino - Baird
Andy Barish - Jefferies
Sara Senatore - Bank of America
Chris O'Cull - Stifel
Dennis Geiger - UBS
Brian Mullan - Piper Sandler
Jeff Farmer - Gordon Haskett
Nick Setyan - Wedbush Securities
Jeffrey Bernstein - Barclays
Gregory Francfort - Guggenheim Partners

Operator

Greetings, and welcome to the Dutch Bros' Second Quarter 2024 Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Paddy Warren, Director of Investor Relations and Corporate Development. Please go ahead.

Paddy Warren

Good afternoon and welcome. I'm joined by Christine Barone, CEO and President; and Josh Guenser, CFO. We issued our earnings press release for the quarter ended June 30th, 2024, after the market closed today. The earnings press release, along with the supplemental information deck have been posted to our Investor Relations website at investors@dutchbros.com.

Please be aware that all statements in our prepared remarks and in response to your questions, other than those of historical facts, are forward-looking statements and are subject to risks, uncertainties, and assumptions that may cause actual results to differ materially.

They are qualified by the cautionary statements in our earnings press release and the risk factors in our latest SEC filings, including our most recent annual report on Form 10-K and quarterly report on Form 10-Q.

We assume no obligation to update any forward-looking statements. We will also reference non-GAAP financial measures on today's call. As a reminder, non-GAAP measures are neither substitutes for, or superior to, measures that are prepared under GAAP. Please review the reconciliation of non-GAAP measures to comparable GAAP results in our earnings press release.

With that, I'd now like to turn the call over to Christine.

Christine Barone

Thank you, Paddy. Good afternoon, everyone. Our results demonstrate the long runway of growth that lies ahead for Dutch Bros. as we once again combined strong revenue growth with expanding profitability.

During Q2, we drove a 30% revenue increase and a 34% adjusted EBITDA increase compared to the same quarter last year resulting in \$325 million of revenue and \$65 million of adjusted EBITDA.

We are very pleased with how our customers are responding to our recent innovations, our expanding Dutch rewards program and our brand awareness building efforts.

Given the intense external promotional backdrop and a tough Q2 lap, our focus on delivering innovative products and incredible service is paying off. Same-shop sales rose 4.1%, and AUVs were \$2 million, which is in line with the record we posted last quarter. In Q2, we opened 36 new shops marking the 12th consecutive quarter of 30 or more new shop openings.

We also reached another milestone this quarter, having opened our 900th shop in Frisco, Texas. Despite an evolving and uncertain consumer environment, our exceptional first half results, including strong new shop performance, give us the confidence to raise both our revenue and adjusted EBITDA guidance for the year.

Josh will share more context and detail on our financial results in a few minutes. But first, I'd like to walk you through an update on our business. We began any discussion of Dutch Bros with our fundamental differentiator, our people. Our exceptional culture, cruise and service resonate with customers of all ages and backgrounds. Our talented Brois and the service they provide drive our growth and set us apart from competitors.

Our people pipeline includes over 400 operator candidates with an average tenure of more than seven years. Each person in the pipeline is ready to lead a market as an operator.

When these new operators get the call, we invest in their success and the success of the market by assuming our experienced opening team. These teams work alongside our new operators to lay a strong cultural foundation and ensure our new Brois are empowered to be highly successful.

This powerful combination of experience, energy, and teamwork helps us consistently deliver an exceptional customer experience focused on speed, quality, and service. We continue to be pleased with our shop level turnover indicators, which are in line with our expectations. Our best people are staying and growing with us.

The expansion of our support center in Arizona, which we announced earlier this year remains on track, and we continue to hire great people to support our growth. We are eagerly awaiting the move into a larger permanent location in the first half of 2025.

Our leadership team transition has been seamless. Josh Guenser officially assumed his role as CFO earlier this quarter, while Charley Jemley remains a strategic adviser. Sumi Ghosh, our President of Operations; and Jeff Enquist, our Chief People Officer, have spent their first several months in the shops, learning our systems and processes. This experience is important as it gives our leaders a unique perspective on the business and helps inform our key initiatives.

Sumi is taking his in-shop learnings and applying them to his initial focus areas of real estate and throughput. Jeff is focused on building on the strength of our people system.

The remaining members of our senior leadership team have all spent time in the shops as well and are all certified Broistas, which we believe is critical in our ability to support the field as we grow.

Last year, we outlined a multipronged plan to drive traffic, which includes an enhanced focus on innovation, increased paid advertising designed to build brand awareness, and more targeted rewards program efforts. Despite the macro environment noise and aggressive price promotion for many peers, we haven't felt the need to fundamentally adjust our strategy.

We remain pleased with our progress and how our efforts are working together to drive momentum. Innovation is a key driver within the beverage market. We also believe innovation plays a foundational role in Dutch Bros' next stage of growth by building sales layers and deepening our competitive moat through category-defining products.

Earlier this year, we demonstrated our advancing innovation capabilities through the launch of Boba and Protein Belk, which were both extremely successful. Our customers love these products, and we decided to add them to the permanent menu.

Our Strawberry Boba performed so well that we experienced product outages through much of April and May. I'm happy to report that by June, we restored supply across most of our system.

In April, we brought back Mangonada Rebel and added two new drinks, Churro Freeze and Watermelon Fizz. With Mangonada and Churro Freeze, we maintain a dual focus on energy and coffee.

With Watermelon Fizz, we highlight the breadth of our menu, which includes an array of refreshing soda, tea, and lemonade based beverages. With our deep pantry of flavors and toppings, we give our customers tens of thousands of ways to enjoy their favorite drink.

Paid advertising. We are beginning to see the impact of increased investment in paid advertising particularly in newer markets with lower brand awareness. We were encouraged by the initial results, which were higher than our expectations. In these DMAs where we have incrementally upsized paid advertising, sequential traffic growth is outpacing the system.

Based on these results, we have decided to make further investments. Dutch Rewards is a cornerstone in our traffic driving strategy and allows us to interact directly with our customers.

Through this communication channel, we introduce customers to new innovative products, communicate special promotions like surprise sticker days and merch drops, and incentivize visits across key customer segments, geographies, and dayparts.

In Q2, approximately 67% of our transactions are attributable to Dutch Rewards members, which we believe is truly incredible given the growth in our business and our status as a relative newcomer in many of our markets. We focused our promotional efforts in the Industrial Rewards channel and elected to not repeat several of our broader-based promotions.

We have found that our increasing sophistication in our Dutch Rewards program enables us to efficiently and effectively target our large existing customer base. That said, we believe broad-based promotions are particularly effective at introducing new customers to Dutch Bros, especially in new markets.

We continue to make progress with our order ahead capabilities and we remain on track with this initiative. We expanded the scope of the test to about 40 shops in Arizona, California, and Texas as of June 30th and have rolled out the capability to approximately 200 shops as of the end of July. We are increasingly optimistic that mobile order capabilities will be available in the majority of our shops by the end of 2024.

We are encouraged by some of the structural advantages we believe we enjoy with this channel, including our approximately 67% Dutch Rewards penetration starting point.

Additionally, many of our shops have double drive-thru setups that include an escape plane, which could be utilized for mobile order. After checking in, our mobile order customers can be directed to the right-hand lane, where a runner can bring their drink if it is ready before the customer reaches the window.

The customer can then escape using that open lane to their right, eliminating a potential bottleneck at the window. We already use this operational tactic in many of our locations.

We also see an opportunity for mobile order to improve the utilization of our walk-up window, which currently makes up about 10% of our business. Early mobile order data suggests a majority of mobile order customers choose to use our walk-up window.

Our existing kitchen display nets are compatible with the system, leading to streamline integration. Based on learnings from competitors, we recognize the importance of capacity planning and setting customer expectations.

We intend to throttle orders where necessary to maintain high levels of customer service across our channels. That said, we believe many of our shops are capable of significantly higher throughput given the volume of some of our most productive shops. These high throughput shops have the same footprint as our standard prototype, which makes up much of our existing portfolio.

We are excited to continue learning from this rollout and we look forward to sharing feedback on adoption and potential incrementality as we observe customer behavior over a longer period of time.

Since our IPO in September 2021, new shop development has been a consistent bright spot for our business, having almost doubled our shop base from 503 to 912 as of the end of Q2 2024. We currently have nearly 200 shops in Texas, which is remarkable given the market opened a little over 3 years ago. We have learned a lot from our entrance into Texas.

As a reminder, we have updated and recalibrated our models over the past 18 months, helping refine our approach to real estate. We are using these insights combined with an enhanced market planning effort to drive better revenue performance in new shops.

As part of this work, we have removed sites for our pipeline that under our recalibrated modeling would not meet our investment objectives. We began these refinements in mid-2023 and have continued to reassess site quality of our pipeline regularly since then.

Rapidly bringing forward learnings into the pipeline process has had two main impacts. First, we have begun to see stronger revenue performance in our portfolio of new shops, which is giving us the confidence to raise our total revenue guidance for the full year 2024.

Second, as we have focused on higher AUV potential sites it is now more likely that we will land towards the lower end of our development range of 150 to 165 new shops in 2024. As a reminder, we have opened 81 shops already through the first half of this year.

Additionally, we are attempting to rebalance our pipeline back towards more capital-efficient lease arrangements. It will take time for these refinements to make their way through the real estate pipeline and we will likely begin seeing an impact in 2025. That said, we are encouraged by the improvements in new shop productivity, which are beginning to be felt now.

Let me conclude with two items that relate to our corporate structuring. This quarter, affiliates of TSG consumer partners fell below the thresholds required to nominate a director to our Board of Directors, maintain elevated voting rights and after the SEC waiting period call for a registered offering under our registration rights agreement.

TSG played a foundational role in preparing Dutch Bros to be a fast-growing, high-performing public company. On behalf of the entire Dutch Bros family, we would like to formally thank TSG for its support over these past six years.

In Q2, we added two independent directors to our Board of Directors, G.J. Hart and Todd Penegor. G.J. has extensive industry expertise and is presently the CEO of Red Robin and the former CEO of Texas Roadhouse, California Pizza Kitchen and Torchy's Tacos. G.J. chairs our Compensation Committee, which is now independent.

Todd also has extensive industry experience and was just appointed President and CEO of Papa John's and a member of Papa John's Board of Directors earlier this month. Previously, Todd served as the CEO of the Wendy's company. He joined Wendy's in 2013 as Senior Vice President and Chief Financial Officer. Prior to his tenure at Wendy's, Todd served in various roles at TeleNova and Ford Motor Company.

We look forward to G.J. and Todd's contributions in our boardroom as we navigate the next phase of our growth story. We are pleased with an excellent start to 2024, and we continue to build a strong foundation for growth.

We have terrific customer engagement through our rewards program and are excited about opportunities in front of us to further accelerate this platform. We have top-tier growth. We delivered 30% year-over-year revenue growth in Q2 and yet another quarter of at least 30-plus new shop openings.

We have excellent shop margins, delivering this top-tier growth profitably. We are well-capitalized. We believe we have plenty of flexibility upon which to execute our growth plan and capture a considerable white space. Most importantly, we have great people anchored by outstanding engaged raises and a strong pipeline of operators ready to grow with us.

With that, I'll turn it over to Josh to review our financials and give more details on our guidance.

Josh Guenser

Thanks Christine. We delivered outstanding financial results in Q2 and thank our entire team for their great efforts. Once again, our performance was headlined by a combination of strong revenue growth, which was driven by positive same-shop sales growth and increasing new shop productivity alongside strong margin flow through.

Here's a brief recap. Revenue growth was 30%. System AUVs were \$2 million, in line with last quarter's record. Systems same-shop sales growth was 4.1%. Company net sales grew 34% with 36% growth in company-operated shop contribution. Four-wall productivity remains strong with company-operated shop contribution margin reaching 30.8%, a 50 basis points increase year-over-year.

Adjusted SG&A was 14.6%, 100 basis points lower than Q2 of 2023. Adjusted EBITDA increased to \$65 million, growing 34% year-over-year. Adjusted EBITDA margin of 20.1% is up 70 basis points over Q2 last year. And we continue to close the gap between cash flow from operations and investments in new shops, as we work towards achieving and sustaining self-funded growth.

The 50 basis points of margin expansion in our company-operated shops was primarily driven by sales leverage, partially offset by increased labor costs. Cost of goods sold decreased 130 basis points year-over-year, driven by strong ticket growth. We continue to keep a close watch on key commodity costs, including the elevated coffee commodity price, which may become a factor in 2025.

Labor costs increased 60 basis points year-over-year, driven primarily by wage growth. On April 1st, our starting wage in California increased about 25% year-over-year. Occupancy and other costs increased 20 basis points year-over-year. Preopening costs as a percentage of company-operated shop revenue were approximately flat.

For the quarter, SG&A was approximately \$58 million, which includes about \$7 million in organizational realignment and restructuring costs and \$3 million in stock-based compensation.

With the exclusion of these items and other non-recurring expenses, adjusted SG&A was approximately \$48 million, falling to 14.6% of revenue compared to 15.6% in Q2 last year.

We are pleased with the leverage we saw in adjusted SG&A in the quarter, which partially benefited from timing of hiring for support roles as we transition people to our Arizona office.

Regarding our balance sheet and liquidity, as of June 30th, we had approximately \$660 million in total liquidity compared to approximately \$662 million at the end of Q1 and we believe that we have sufficient liquidity at our disposal to support our current growth plans.

As of June 30th, that liquidity was comprised of the following elements; \$261 million in cash and cash equivalents, \$349 million in undrawn revolver, and \$50 million in undrawn delayed draw term loans.

In the quarter, interest expense net declined \$2 million from one year ago to \$7 million. The decline is primarily driven by income received on our investments in marketable securities and reductions in interest paid on outstanding balances in our credit facility, which together amount to a \$3.4 million reduction in interest expense net. This was partially offset by an increase in interest expense related to finance leases of \$1.4 million, which rose from \$4.1 million in Q2 2023 to \$5.5 million in Q2 2024.

As of June 30th, we had \$382 million in finance lease liabilities and \$285 million in operating lease liabilities. During the quarter, we added \$3.5 million in finance lease liabilities to our balance sheet and \$49 million in operating lease liabilities, which included \$18 million for our new support center office.

Regarding cash flow and capital expenditures, we continue to move towards having a self-funding business, which we believe will provide us maximum optionality in our long-term capitalization.

We expect the combination of an expanding base of profitable shops a rebalance towards more capital-efficient lease arrangements and control over adjusted SG&A will move the business towards this goal.

The growth of our company-operated shop base continues to expand our cash flow from operations. In Q2, we generated \$60 million, up \$17 million from Q2 of last year. This compares to \$64 million in purchases of property, plant, and equipment this quarter, which was \$5 million more than Q2 of last year.

As noted, we look to reduce the business' capital intensity through blending down new shop development costs on a per unit basis. This process will take time, and there's more work to be done. That said, we believe that in 2024, per unit new shop CapEx may represent a high watermark.

Given the continued strength of our business performance, we are updating guidance for the balance of the year. Total revenues are now projected to be between \$1.215 billion and \$1.23 billion or an increase of \$15 million from our updated guidance from last quarter. Adjusted EBITDA is now estimated to be between \$200 million and \$210 million or an increase of \$5 million from our updated guidance from last quarter.

We now expect adjusted SG&A to be between \$190 million and \$200 million, up from the prior range of \$183 million to \$189 million, as we invest in driving the business forward with upsized paid media to build brand awareness in new markets and hiring to support our expansion in Arizona as well as increased performance-related compensation.

Total system shop openings are projected to be near the bottom of our previously provided range of \$150 million to \$165 million. As a result, capital expenditures are now estimated to be in the range of \$270 million to \$290 million.

There are no changes to our original guidance as it relates to same-shop sales growth. Same-shop sales growth expectations for the year remain in the low single-digits. As a reminder, we're rolling off approximately 450 basis points of pricing action from last summer. And while we remain confident in our traffic-driving initiatives, we will be navigating through an uncertain consumer environment in the near-term.

In summary, we continue to be pleased by the results of our performance in 2024.

Thank you and now we will take your questions. Operator, please open the lines.

Question-and-Answer Session

Operator

Thank you. We will now be conducting a question-and-answer session. [Operator Instructions]

First question comes from Sharon Zackfia with William Blair. Please go ahead.

Sharon Zackfia

Hi, good afternoon. Thanks for taking the questions. I guess first question is just a clarification. I think there's some concern that the comp guidance might imply negative comps in the back half of the year. So, maybe if you could address that?

And then separately on mobile ordering, I think one of the ideas of mobile ordering was potentially redeploying some labor. And I'm curious if that is happening at the locations where you have mobile ordering? And if so, are you seeing improved customer satisfaction and/or throughput? Thank you.

Christine Barone

Yes, absolutely. So, I'll start with mobile order and then Josh and I will tackle the same-shop sales question. So, thanks, Sharon. On mobile order, it's really early days. So, it's really in just about 40 shops for a longer period of time. And from a redeployment of labor, what we're incredibly focused on is customer service is really our differentiation.

And so it's ensuring that as we roll out mobile order that our teams are really focused on still providing that incredible connection that we have with our customers. So, making sure we have the time both at the window and in the drive-thru for those mobile order customers.

And so in thinking about kind of what -- what happens with the transaction, it's really what's happening is that taking the order itself, which is actually the least interactive part of our interaction with our customers. That goes away and move to your phone and so what happens is we can redeploy that labor to have a conversation to make sure someone's day is going great.

And so all of those things we believe, are starting to happen. And I think our Broistas are really excited just by how seamless the initial operational experience feels with mobile order.

And then moving on to the same-shop sales question. Just to address the quarter first. So, we're really pleased with first half of the year and this quarter and what we're seeing from our customers in general.

We were comping over a number of large-scale promotions that we decided not to repeat this quarter just based on things we were seeing and the strength that we're seeing in our rewards program, the strength that we're seeing and the innovation that we see and the strength that we're seeing in the paid advertising. I'll hand it over to Josh to kind of deconstruct that second half of the year for you.

Josh Guenser

Yes, Sharon. So, maybe just to decompose Q2 for a moment, the 4 -- roughly 4 points of comp included about 7 points of price, and that was partially offset by about 1 point of mix. And then we saw sales transfer come in the lower end of our range of 2 to 3 points.

So, as we think about that carrying forward we are rolling off, as mentioned, rolling off about 4.5 points of price going into Q3. We replaced that with a little bit more than a point of price in Q3 as well.

But we would expect, as we're heading into the balance of the year, we're going to increase some investments in promotional activities, which ends up showing up in discounts here, but would put a little bit more pressure on that side of the house.

So, if you just were to kind of build back down the rest of the year based on Q2's performance, that's how we're thinking the rest of the year will shape up.

Sharon Zackfia

Thank you.

Operator

Next question, Andrew Charles with TD Cowen. Please go ahead.

Andrew Charles

Great. Thanks. I wanted to ask about the guidance as well for same-store sales. Does that contemplate the potential lift for mobile order I know that obviously, you ended the quarter with around 40 stores, but now that you're at 200, you're nearly 25% of the store base here. So, does the guidance reflect potential benefit from mobile order?

And just a related question there. I mean how quickly are you seeing this? I know you're not giving numbers at this point, which is fine, but just from a qualitative perspective, how quickly do you see mobile order typically kick-in in terms of the lift to sales of incrementality when you introduce it to new stores?

Christine Barone

Yes, absolutely. So, as you know, with mobile order, we're still in the very early innings of what's happening there. From an operational perspective, which is where we're most focused right now, is it's really actually the best for our stores that it happens gradually.

So, as we roll out these capabilities and new shops, we are doing very limited sharing that it's actually available. So, you can certainly see that it's available on the app, but we're being very thoughtful to make sure that our shops actually have time to kind of get used to this new functionality. They get to see how it flows through their orders and all of those things.

And then as far as going forward, we continue to believe that this is going to be a larger driver in 2025 given the thoughtfulness that we are rolling this initiative out with.

Andrew Charles

Thank you.

Operator

Next question is John Ivankoe with JPMorgan. Please go ahead.

John Ivankoe

Hi, thank you. The question is on unit development, and there's a couple of different places I want to go with this. Firstly, lower end of your guidance for the year, we get that. I mean it does imply slowdown in the second half relative to what we were previously thinking. So, of course, I have to ask what this means for 2025. Do the brakes go on further or will 2024 be a trough year in 2025 to pick up? That's the first part of the question.

Secondly, you did mention Sumi's focused on real estate and throughput, might he be working on or looking at kind of a Dutch Bros of the future, if you will, location, maybe design that could just allow the box to be even more productive than it previously was. Thank you.

Christine Barone

Yes, absolutely. So, first, I'll talk about unit development. So, really, I think there's two primary dynamics to pay attention to here. One, we are seeing higher new shop AUVs this year. And that is one of the main reasons we felt very comfortable raising that revenue guidance. And as we look at the long term, we believe, again, we're in the very early innings of building this brand and building our long-term potential.

And so having that long runway in front of us, we're super focused on the returns on our new shops, the productivity of our new shops in the AUVs of our new shops. So, we're super encouraged that some of the market planning activities that we've been working through really over the last 12 months or so are really beginning to bear fruit.

So, as you look at that, I think that, that's the primary piece is that as I look at kind of the productivity and what we're seeing from new shop AUVs. We're really encouraged with what we're seeing.

From a development and a number of units as we work through that market planning work, as we've shared before, we're really doing two shifts. So, one, we're recalibrating our models and ensuring that we have the most recent data as far as what our predictability of what our AUVs will look like when they open, and that's a continuous exercise that will be ongoing. And again, very pleased with early results.

The second piece that we're looking at is trying to bring down the overall per unit shop CapEx as we go forward. And it's really the combination of shifting those two things where, as we look ahead, at the potential that we have, there's a lot of great shops we have in front of us.

And so we're kind of in a temporary time period here where we're adjusting a strategy where we decided it made sense given how many great high AUV shops we have in front of us to potentially take down a couple of shops this year to make more room for those.

John Ivankoe

And if I'm still on, as it relates to 2025's specifically, I understand that you're trying to get some costs out of the box, but is there potentially some redesign of the box as well to increase its throughput.

And then secondly, you made, I think, two separate times comments about your desire to be a self-funding business. What year do you expect Dutch Bros to be a self-funding corporation? Thank you.

Christine Barone

Great. And then on the redesign and Sumi's focus on throughput, I think we're still in the very early days. Sumi spent much of his first couple of months in shops and working on the bar. And so I do believe that we have -- we do have opportunities in throughput, but I wouldn't share that we have something that we would share at this point as far as what Dutch Bros of the future might look like.

Josh Guenser

Yes John and then on your question on self-funding, I think there's two points I'd want to make. As we comment on driving down the capital or contributing to new shops is really a function of how we negotiate the lease and structure those leases. So, we're driving down the amount of capital that's Dutch is contributing to the cost of the build. It's less about the full redesign of a shop.

Now, as we think about this going forward and the factors that are going to lead to eventually getting to cash flow breakeven are going to be continuing to drive margin growth and strong EBITDA performance.

And then it's going to be a function of the rate at which we can start shifting the reduction in our overall capital that we're contributing to these sites and the pace at which we're opening in shops.

So, for now, we're not commenting on when that is, as I spend some more time getting into the business and developing our longer term model, it's certainly something I'd like to be able to update with you guys here in the future.

John Ivankoe

And it sounds like since I asked twice, 2025 development, we're not going to discuss on this call. Is that -- I'm kind of making fun of myself a little bit now. Is that what you want to communicate?

Josh Guenser

Not on this call.

John Ivankoe

Thank you.

Operator

Next question, David Tarantino with Baird. Please go ahead.

David Tarantino

Hi, good afternoon. First, I just wanted to clarify, Josh, the second half commentary on the guidance for comps. So, were you -- I guess, all the moving pieces there, were you indicating expectations for average check growth to kind of settle into the flattish range and that maybe you would extend the traffic ex the cannibalization that you saw in the second quarter, which I think was flat. Correct me if that's wrong. So, that then the net of that would be that comps would be flattish in that scenario. Is that the right way to think about it?

Josh Guenser

Yes, I think you're getting the math about right. The way I would describe it is we'll have about 4 points of -- around 4 points of price that would be offset by some mix and increased promotional investments that increased discounts. And then we'd have the underlying sales transfer that we referenced that would drive it down with not any meaningful changes on the underlying traffic.

David Tarantino

Got it. Okay. And then I guess one follow-up to that. Is that sort of what you're already seeing? Or is that what you expect to see as you move forward? I guess what I'm trying to get at is this already the run rate that you're seeing in July or the third quarter, and that's informing your guidance? Or are you may be factoring in some uncertainty in the outlook from here?

Josh Guenser

Yes, what I say is we've -- certainly, we're aware of what's going on in July has factored into the guidance that we're providing. So, not commenting specifically on the performance here. What I'd say is there's nothing jumping off the page for July that would cause us to think differently about the guidance we're providing.

David Tarantino

Great. Thank you very much for that.

Operator

Next question, Andy Barish with Jefferies. Please go ahead.

Andy Barish

Yes, hey guys. I guess just 1 more thing on the consumer and the environment. You noted a volatile consumer backdrop. How is -- I guess, how is that being witnessed in your business, which on the surface appears really, really solid?

Christine Barone

Yes, absolutely, Andy. So, I do think we feel really good about our performance in Q2. And if you think about just that meaningful step-up in year-over-year comp between Q1 and Q2 of 2023, we feel really good about where Q2 came in.

We also -- I think as we went through the quarter, felt comfortable just with the playbook that we've got in place, we are continuing to see great returns from innovation.

As you know, we kept Strawberry Boba. We kept protein on the menu. Those continue to do well throughout the quarter, especially when we had Boba actually back in stock.

We're also continuing to see really nice performance in building brand awareness and our newer markets with that paid advertising. So, we'll look to make additional investments as we go through the year. The neat thing about that is we can watch those returns pretty quickly as far as what it's driving. And so make decisions on what we're seeing from a return basis on that advertising as we go through the year.

And so as far as the customer, what we're feeling right now is that think broadly that there's -- of what's going on with our customer. We have always been a very generous brand. I think that, that generosity is important right now. Our medium size is 24-ounce drink. We're doing a lot of ICE business right now. Over 90% of the business in the quarter is in the ICE space.

We give out a lot of top cups and even try to make the dogs happy. But I think I think that the way that we're really responding right now is, as we always do, we are super empathetic with where our customer is and what they're thinking about.

And I think our goal is to stay ahead of what's happening right now and continue with that generosity that we've got in our rewards program and continue with the generosity that our Brois delivered to our customers every day.

Andy Barish

Yes, makes sense. And then just, Josh, on the discussion on the seat price on coffee, maybe looking out to 2025, anything in the back half been discussion around dairy and cocoa and sugar. Anything you're seeing that would be material in terms of the cost of goods line? Or you feel pretty comfortable with that?

Josh Guenser

Yes, I'd say the way we're thinking full year, we'd expect it to be still fairly flat for us. We did see through the quarter a little bit of increase in dairy costs, but nothing significant that we're expecting for the full year for the balance of the year.

Andy Barish

Okay. Thank you.

Operator

Next question Sara Senatore with Bank of America. Please go ahead.

Sara Senatore

Thank you. I just had a quick clarification. In terms of -- you mentioned refinements in your process. I guess, are you talking about applying that to Texas? Or is it new markets? I'm just trying to understand kind of how broad this approach is?

And I assume, as you said, it doesn't change how you think about the ultimate TAM. It's more about this year kind of a one-time adjustment, I guess, is I want to make sure that I'm understanding that correctly, a one-time change in your process.

And then I do have a question about your underlying business. I understand all the desire to be generous with customers, but it looks like actually it was pretty stable sequentially. If I try to control for all the different compares and that kind of thing. So, I'm curious given all the drivers that you have, why you wouldn't expect if price rolls off and you're more promotional that you would get an offsetting benefit in traffic? Thanks.

Christine Barone

Yes. So, I'll start with the real estate process there. So, I do think that there are some changes in our real estate process that we've noted previously, which I'll go through that are more of like a one-time shift. And then there's other things that are going to be continuous and ongoing, those learnings from what we learn as we enter new markets and from all of our shops.

So, I think that more of what is happening this year and more of one-time or some of those shifts from -- we mentioned going wider versus deeper and so one of the things that we are -- as we incorporate more data, in particular, because we just opened so many shops in Texas, a lot of that data is coming from Texas is that we just have more refined data on what we look like, how we ramp in a new market.

We have more refined data now on sales transfer and what that looks like under various different types of scenarios. And as we enter big new markets like Florida, we are using all of that data to really refine our approach so that we can bring up the average AUV of a unit. That's the goal of that process.

And what it has led to is we have a very refined real estate process now where we're looking site by site at each site what all of those impacts look like and feel like we have a higher level of confidence in what our AUVs will look like as we open in new markets.

And so what that leads to is us feeling that going forward, we're excited about the pipeline that we're building right now because of that increased confidence in the estimates that we have as we go forward.

The second part of the refinements that we're making is really moving the amount of money that we spend at Dutch Bros on a site. And so I think we've talked previously about ground leases and build-to-suit.

A lot of what we're seeing right now in the market is a hybrid mix between those two and so as we've shared, we believe 2024 could be that high watermark for the ground leases, which is the most expensive way for us to spend money to get a shop out of the ground.

And we are refining that back towards build-to-suit and what we're finding in the market that a number of developers are looking for some level of contribution. So, ending up in some of that hybrid space. So, that's the other piece that we are working on as well.

I think the other dynamic that we're starting to see in the market, I think, has as there might be others out there that maybe aren't pursuing sites as aggressively as they were or might be looking to find someone else to take a site is that we believe that there's -- that we could be entering a new kind of scene in the market where we might actually have some more attractive sites available. And so again, all of these things, the refinements in our real estate process we're feeling really good about the direction that we're going there.

And then as far as your comment around pretty stable, like I would echo that comment that when you move from Q1 to Q2 with all of the underlying drivers, what we are seeing is a pretty stable environment.

Josh Guenser

That's right. And Sara, maybe just to answer your question prior on the TAM, we certainly don't see any shift in that as well. I think you highlighted that, but I just wanted to confirm that we still feel very confident about the long-term potential of this business.

Sara Senatore

Right. Okay. And then just on the environment, I guess, question was why wouldn't you get then better transaction growth if your ticket is coming down because of less price and promotions, why wouldn't you assume there'll be some payoff in higher transactions?

Josh Guenser

I think we certainly want to be mindful of the environment that we're operating in. I think we're seeing around us, there's an increase in concern in the consumer space. We want to make sure we're very thoughtful about how we're positioning ourselves going forward.

Sara Senatore

Got it. Thank you so much.

Operator

Next question, Chris O'Cull with Stifel. Please go ahead.

Chris O'Cull

Yes, thanks. I just had a follow-up and a clarification regarding that question. You mentioned plans to increase that promotional activity in the third quarter, which is going to impact the mix. Is that related to the competitive environment? Or is it related to the rollout of mobile order and pay? Or what's the what's the impetus behind increasing that promotional activity?

Christine Barone

Yes. So, really, it's more of a comment on year-over-year. So, as we've changed the rewards program in Q1 of 2023, as we were kind of ramping up our ability to segment the offers on our ability to know which offers were most effective, we had a little bit of a lighter kind of environment in the rewards program in Q3 of 2023.

And so looking in this year, I think, again, staying ahead of our customer really staying on the same pace that we've been on. We believe it's really important to continuing to have the great reaction that we're seeing right now from our customers.

Chris O'Cull

Okay. And then, Christine, you mentioned plans to make additional investments in paid advertising. Can you quantify that investment? And then -- how are you thinking about budgeting advertising going forward? I'm just wondering if you'll be able to try to keep it as a percentage of sales so that it will grow with unit growth and comps as you look out in the next few years?

Christine Barone

Yes. So, what I can share is that there's increased advertising -- the increased advertising spend is included in our guidance. And as we go forward, I think we are still in that learning phase of where can we maximize building brand awareness and helping to drive new customers into the brand.

And so I think we are still learning where that right amount of advertising spend is ultimately going to land. I think the good news right now is with the returns that we're seeing, we're not quite there yet with where we believe we can really continue to drive the business in a profitable way with paid advertising.

Chris O'Cull

Okay. Thanks.

Operator

Next question, Dennis Geiger with UBS. Please go ahead.

Dennis Geiger

Great. Thank you. I want to ask one more on promotions and really just following-up on your comments about the increasingly, I believe it was increasingly intense promotional environment. Anything to add there on sort of where that increased intensity maybe is coming from, how it's impacting your business, if that's been a change relative to prior quarters?

Christine Barone

Yes, I mean as far as where it's coming from, I do think that just in general in the market, there's a lot more promotional activity than there has been historically. And so certainly kind of watching that really across the beverage space and even broader than the beverage space.

And then from what we're seeing, we, again, believe our best strategy is to really understand our brand and our customers really well and what's going to work within our shops.

And so in Q2, what we really found most effective was to continue with the strategy that we've been deploying for the last several quarters, which is that focus on innovation really after our core customer, things that are fun, oftentimes need to market ensuring that we have that dual focus now on coffee and on energy given how important the energy business is to our growth.

I think we've talked a lot about paid advertising and what we're seeing there. And then again, we are compared to others, I think, in the early stages of what we can do with the rewards program.

And so each quarter, it's a little bit of a march ahead and figuring out how to segment, which offers our customers are most responding to. What are other things we can do extra sticker drops other merch drops, things like that, that really make sense and resonate with our customers.

So, I think that we are being thoughtful about the environment that we're working within. And what we're seeing at the same time is that a focus on our strengths within our brand and with our service are really what's paying off for us.

Dennis Geiger

That's very helpful, Christine. Just one more as it relates to Florida and sort of any incremental thoughts to share there based on sort of early days observations? Thank you.

Christine Barone

Yes. We're really pleased with how the Florida rollout is going so far. I think it just reflects the strength of our brand that our customers will drive so far to come to our shops to potentially waiting some lines that we have in Florida.

And again, we -- I think we're very thoughtful about not projecting what Florida is going to look like from just a couple of shops. But certainly, the initial shops are performing really well.

Dennis Geiger

Thank you.

Operator

Next question Brian Mullan with Piper Sandler. Please go ahead.

Brian Mullan

Thank you. Just wanted to ask a question on California. Can you just talk about the dynamics in that market since April 1st? Remind us how much maybe incremental price you took there? And what are you seeing from a consumer response perspective in regards to traffic in California, if anything?

Christine Barone

Yes. So, in California, we had about a 25% wage increase. California, holistically is about 20% of our shop base. So, we've been watching really carefully. As far as pricing, we took about what would end up being about a 1.5% weighted on the system in California.

And as far as what we're seeing, we're watching kind of that overall P&L. We're watching some of the new shop openings in California of which we actually had two of our very top first week performers in California in the first half of this year. And I think we continue to be very bullish on our prospects in California and continue to look for sites and we'll continue opening shops in California.

Brian Mullan

Okay. Thank you. And then just a follow-up on the mobile order pay testing. You referenced some excitement around better utilizing the walk-up window, which was interesting. Are you doing anything in these tests to proactively direct to consumers to the walk-up window? Or is that occurring naturally? And do you have an actual preference what they do? Just curious to get your take on that part.

Christine Barone

Yes. So, given it's still early days of the testing, we really want to understand what our customer preferences are and how they work. There are unique situations in our shops where it's better for us direct to one place or another just because of either parking or because of how the line works, all of those things.

But what we are seeing kind of early on is customers choosing more to come to the walk-up window, I think that might be more typically of how they're picking up their mobile orders at other places and so kind of repeating that behavior with us.

One of the things for us that's nice about that is we have two bars, one is the drive-thru window and one at the walk-up window and then in high-volume shops, we put in additional bars. And so the new thing, I think, with mobile order and that preference for the walk-up window is it really is balancing out some of that volume.

So, typically, if you've got much more of that volume coming out of the drive-thru window, what we're doing is we are actually walking drinks from the walk-up window side over to the drive-thru window side. And so that ability to actually make the drinks where they're being handed out, is a nice thing that we're seeing, again, very early on in the mobile order testing.

Brian Mullan

Thank you.

Operator

Next question Jeff Farmer with Gordon Haskett. Please go ahead.

Jeff Farmer

Thank you. I apologize for continuing to harp on the 2024 same-store sales guide. But I guess, in an effort to get everyone on the same page, is the implied same-store sales guidance for the back half of the year could we consider it flattish? Is it slightly negative or somewhere in between? Do you guys have anything you can offer on that?

Josh Guenser

Yes, I mean, I guess all I would offer is similar to what I provided in the past. We're not giving specific guidance on the back half of our quarterly guidance. But as you think about the rollover from -- the best way to think about it would be the rollout from Q2 into Q3, where we had 4 comps for Q2, we'll be rolling off about 4.5 points of price.

We replaced about a little more than 1 point of that back in price and we'd expect slightly higher promotional activities driving some discount and mix. So, I think you guys can do the math to get to what that would imply then for Q3 and Q4, but I put that into the full year guide as well.

Jeff Farmer

Okay, I'll leave that alone. And then just the follow-up. So, just drilling down on your own customers. You guys have talked about it on this call, but in terms of just the competitive intensity picking up, consumer headwinds picking up. How does that manifest itself in terms of your customers' behavior? And I guess, wondering about that, do you see sort of reduced frequency or check management? What happens when these headwinds arise, that's the first question.

And secondly, do you think we're sort of absorbing the peak of these headwinds? Or is this something that's continuing to intensify as we get through 2024, the headwind perspective?

Christine Barone

Yes. So, there's a number of different things that we are looking for as we look for potential things that we could be seeing. We do track a constant cohort of rewards members. I recall that behavior we're seeing there is stable. And so nothing really there. We also look at add-ons, modifier usage, things like that. Again, we're not really seeing anything in the data that would indicate anything there.

And I do think it's part of what we're looking at is just, hey, if the overall environment, clearly, everyone's customers is feeling something. And so how do we stay ahead of that. And I think that, that's what we've done a really good job of thinking through in this type of environment, what do our customers most want and how do we continue to deliver that.

So, that we don't end up seeing some of those things that might start to show some cracks. And so right now, we're really very pleased with what we're seeing and how our customer is holding up.

Jeff Farmer

Appreciate it. Thank you.

Operator

Next question Nick Setyan with Wedbush Securities. Please go ahead.

Nick Setyan

Hi. Thanks for the question. The increased SG&A guide, can we just kind of parse out all the different drivers of that uptick?

Josh Guenser

Yes, yes. Happy to walk through without giving specific dollar amounts, what we've got in there is increased investments both in paid media as well as in our support center roles as we've made the transition.

Certainly, there was a bit of a slowing in the first half as we were transitioning folks to this office, we're ramping up those efforts here in the back part of the year. That's going to be the good size of that increase and then the balance being is we've had a very strong year, increased performance-related compensation. So, those are the three biggest pieces that I'd highlight for balance year.

Nick Setyan

Okay. And I think just to clarify, you guys said you're not too worried about the dairy or coffee impact in the second half, is that fair?

Josh Guenser

That's right. Yes. We don't have anything significant in there obviously keeping an eye on it. We will follow all that closely, but currently aren't anticipating any impact.

Nick Setyan

Okay. And then is it kind of fair to say that given sort of the increased ad spend, lower cannibalization because you're being more selective from unit openings, increased promotional activity are basically putting that all those headwinds into the comp, but you're not necessarily taking credit for any kind of incremental transaction growth that those things might result in?

Christine Barone

Yes. Look, I think that we are taking the things that we know today into our guide, and that's how we would think about it. As far as the sales transfer comment, I do want to just comment specifically on that, that we are still quite like from a business perspective, from a strategic perspective, we do believe that there is a healthy level of sales transfer and feel very comfortable having that.

I mean when we put a new shop in is more convenient for someone who loves Dutch Bros and they decide to go to that more convenient shop. We're really -- that makes a lot of sense for us.

And so that that is not a number that we're really actively trying to guide down. We just want to make sure that we have a very thorough understanding of what it will be and what it will look like as we open new shops. And so we did want to comment specifically on that.

Nick Setyan

Okay. Thank you very much.

Operator

Next question, Jeffrey Bernstein with Barclays. Please go ahead.

Jeffrey Bernstein

Great. Thank you very much. Just curious on the rewards program. I think you said it's now 6% to 7% of transactions. Just wondering what are you seeing in terms of average check and frequency of those consumers seemingly or I think they spend more and come more often, which would be both net positives. But any statistics you have around rewards versus non-reward members and how they use the brand?

Christine Barone

We don't break that out right now. But what I can share is 1 of the things we've been really focused on is given what we do see in the rewards program, we are excited to bring more customers into that rewards program. I do think that it's something that if someone comes to experience our brand.

We have very high customer satisfaction ratings at that first visit. And so we truly believe that we have high conversion rates. And so I think one of the important things we did with the rewards program was to reinstate the free drink welcome awards. And that has really allowed us to kind of keep that penetration up even as we're entering many new markets. But again, really, really pleased with what we're seeing.

And then I also think, given that 67% of our transactions are going through our rewards program, we do believe that, that is going to be something that's going to be very helpful as we roll out mobile order. So, mobile order is really just an update to the app, and that functionality becomes available on the app that you're already using to get your rewards.

Jeffrey Bernstein

Understood. And then the mobile just because you mentioned it, I guess, the 40 units where you have several weeks' worth of data. I'm just curious, like, how would you define success? It sounds like you're happy with it in the early days.

But is there any kind of metrics you're looking for or a sales lift or anything along those lines as you know, you're pushing that 200 and you're going to be across most of the system by the end of the year. So, just trying to gauge what you're looking for to view as overall success?

Christine Barone

Well, we are looking at a lot of metrics, I would say that really the most important one right now are the operational pieces and how does this work for our Broistas because I do think that in the early stages of a rollout, our Broistas are the ones who are having our conversations with our customers. And if they really feel like mobile order is easy, they feel like it's helping their customers and providing them something that really works that's actually the most important thing that we're looking for right now. And kind of what we're seeing initially is we really believe we're on track there and feeling good about what we're seeing initially on mobile order.

Jeffrey Bernstein

Thank you.

Christine Barone

Thank you.

Operator

Next question Gregory Francfort with Guggenheim Partners. Please go ahead.

Gregory Francfort

Hey. One is just the technical -- Josh, when does that pricing roll off in the quarter? Was that at the beginning of the quarter? And then one have a question.

Josh Guenser

Yes, at the start of the quarter.

Gregory Francfort

Okay. And then just on the NSP improvements, are there any themes to that? Is that rolling some of the Texas openings out of new stores into the comp base, you think is getting advertising right in some or all of your new markets? Is there any regionality? Just any other thoughts on -- it seems like it's been a big improvement?

Christine Barone

Yes, absolutely. So, I think as we look at improvements there, I think it's a number of different levers. I do think the recalibration of our real estate process, the strength that we have in market planning is likely the primary driver right now of that new shop performance and productivity.

I do think we are also learning a lot from the paid advertising. The paid advertising is really concentrated on our new markets and in building brand awareness. But I think that what we are seeing is very intentional from the actions that we are taking from a real estate process and strategy perspective.

Josh Guenser

I mean, Greg, maybe the final piece I'd add to that is it's a big function of why we're taking our total sales guide up is that we're seeing really strong performance there. It is a function of all the great things that Christine highlighted and the comp base grew as well from a productivity perspective. So, we're seeing this really good strength possibly.

Operator

I would like to turn the floor over to Christine for closing remarks.

Christine Barone

Thanks for your questions. On May 17th, we held our annual Drink One for Dane Day. Our customers and crews came together to honor our co-Founder, Dane Boersma, who passed away in 2009 following a battle with ALS. This is one of the most meaningful days of the year for Dutch Bros. And since our IPO, we have donated more than \$7 million to the Muscular Dystrophy Association to help find a cure for ALS.

The impact Dutch Bros is making in our communities and the lives of our Broistas continues to grow. We are pleased with our results in Q2 and believe our business is in a position of strength.

I want to thank all of our teams that create this exceptional performance by connecting with our customers and communities every single day. Thank you.

Operator

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

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