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FAT Brands Inc. (FAT) Q2 2024 Earnings Call Transcript

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Q2: 2024-07-31 Earnings Summary

[Play Call](#)[Slides](#)[Press Release](#)[10-Q](#)EPS of -\$2.43 **misses by \$0.99** | Revenue of \$152.04M (42.41% Y/Y) **misses by \$2.46M**FAT Brands Inc. (NASDAQ:[FAT](#)) Q2 2024 Earnings Conference Call July 31, 2024 5:00 PM ET

Company Participants

Andrew Wiederhorn - Chairman

Ken Kuick - Co-Chief Executive Officer and Chief Financial Officer

Conference Call Participants

Joseph Gomes - Noble Capital

Alton Stump - Loop Capital

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to FAT Brands Inc. Second Quarter 2024 Earnings Conference Call. At this time all participants have been in a listen-only mode. Please note that this conference is being recorded today, July 31, 2024.

On the call from FAT Brands, our Chairman of the Board, Andy Wiederhorn, and Co-Chief Executive Officer and Chief Financial Officer, Ken Kuick. This afternoon, the company made its second quarter 2024 financial results publicly available. Please refer to the earnings release and earnings supplement, both of which are available in the Investors section of the company's website at www.fatbrands.com.

Each contain additional details about the first quarter. But before we begin, I must remind everyone that part of the discussion today will include forward-looking statements. These forward-looking statements are not guarantees of future performance, and therefore, undue reliance should not be placed upon them.

Actual results may differ materially from those indicated by these forward-looking statements due to a number of risks and uncertainties. The company does not undertake to update these forward-looking statements at a later date. For a more detailed discussion of the risks that could impact future operating results and financial condition, please see today's earnings release and recent SEC filings.

During today's call, the company will also discuss non-GAAP financial metrics, which I believe can be useful in evaluating its performance. The presentation of this additional information should not be considered in isolation nor as a substitute for the results prepared in accordance with GAAP. Reconciliations to comparable GAAP measures are available in today's earnings release.

I would now like to turn the call over to Andy Wiederhorn, Chairman of the Board.

Andrew Wiederhorn

Thank you, operator. I'd like to begin by thanking all of our team members, franchisees and dedicated employees across our brand portfolio. Their unwavering commitment and strong execution are the driving forces behind our continued growth. First, let's briefly discuss our financial highlights for the second quarter. Total revenue grew 42.4% to \$152 million compared to \$106.8 million in the prior year quarter, driven by the acquisition of Smoky Bones in September of 2023. System-wide sales grew to \$614.7 million, a 7.3% increase when compared to the prior year quarter.

Turning to profitability. Adjusted EBITDA was \$15.7 million compared to \$23.1 million in last year's same quarter. It's important to note that in Q2 of 2023, we received employee retention tax credits of \$12.7 million versus \$2.1 million in Q2 of this year, a difference of \$10.6 million. If you exclude the ERT fees and you look at adjusted EBITDA on an apples-to-apples basis, our adjusted EBITDA actually increased \$2.8 million or 30.8% in Q2 of 2024.

Over the last several years, FAT Brands has experienced significant expansion, boasting a portfolio of 18 diverse brands to support this rapid expansion and to follow and to allow for continued growth, which together form the cornerstone of our strategy, we have implemented a robust and comprehensive management and systems platform.

The infrastructure was designed to not only sustain our current brands but also enable an efficient and accretive incorporation of other brands that we may acquire. This month, we were recognized for our commitment to excellence throughout our continued growth, our new spot on Time Magazine's and Statista's America's best midsize companies of 2024 list.

The list factored in revenue growth, employee satisfaction and sustainability transparency. Our brands also achieved many accolades over the quarter, including 11 of our brands being named to Technomic's top 500 list for 2024, which ranks the highest grossing restaurant brands in the U.S. It has always been recognized by Technomic Ignite consumer for the highest score and the value amongst other fast casual brands. And Marble Slab Creamery receiving a top spot on USA TODAY's 2024 10 Best Readers' Choice Awards list in the dessert and treat category.

Now let me provide some updates on each of our three strategic priorities. First, organic growth. As of June 30, 2024, our franchisee base consisted of approximately 790 franchisees who operate in aggregate of approximately 2,100 restaurants, including restaurants under construction. We also directly own and operate approximately 190 corporate restaurants across four brands.

In the second quarter, we expanded our footprint by opening 24 new locations, bringing our total year-to-date openings through July 31 to 45 units. We anticipate opening 120 new units in total this year, which is comparable to the amount of new stores we opened in 2023. Both established and new franchisees alike are actively signing new development agreements for not only brands they currently own and operate, but also for other brands within our portfolio.

This ongoing investment and diversification by our franchisees is a strong indicator of the overall health and confidence within the FAT franchise system. Our development pipeline remains robust with over 1,100 additional units slated to open in the coming years. We project when opened that this substantial pipeline of additional units can generate approximately \$50 million to \$60 million in incremental adjusted EBITDA, which provides an opportunity to organically reduce our leverage. As part of this pipeline, we are prioritizing accelerated growth within our polished casual segment, which consists of our Twin Peaks and Smoky Bones brands.

Twin Peaks is currently our fastest-growing concept with average unit volumes at company-operated locations of \$6 million, but at some key market locations, particularly in Florida, locations generate sales between \$9 million and \$12 million. Twin Peaks currently operates 113 locations, up from 83 locations when we acquired the brand 2.5 years ago. During the quarter, we opened a lodge in Naples, Florida. And in July, we opened a restaurant in Fort Mill, South Carolina, our fourth location in that state.

Most of our development pipeline is weighted to the back half of the year when we plan to open 12 to 15 total new Twin Peaks ending 2024 with approximately 125 lodges. This will equate to a growth in unit count since our 2021 acquisition by approximately 50%.

Over the next five years, the Twin Peaks development pipeline calls for 125 additional new restaurants, potentially driving system-wide sales to around \$1 billion and 250 units by account. The opening of these restaurants will increase the mix of franchise locations to between 75% and 80% of the total unit count. As you know, we purchased Smokey Bones in Q4 of last year.

Our intention is to use Smoky Bones to fuel Twin Peaks growth through conversions, while over time still restoring the Smokey Bones brand to the 120 unit count, it once had. This fall, we will complete our first Smokey Bones to Twin Peaks conversion in Lakeland, Florida. We expect several additional conversions to take place later this year, with the majority occurring throughout 2025 and 2026.

In May, Twin Peaks and Smokey bones as a combined entity confidentially submitted a registration statement to the Securities and Exchange Commission to become a stand-alone public reporting company. While the timing and the size of any transaction is subject to market conditions and other factors, we are working diligently to expedite a successful transaction. We view an IPO or alternative transaction as an opportunity to monetize the business for the benefit of FAT shareholders. We plan to use proceeds to deleverage the balance sheet and build new restaurants. We are also planning to refinance our Twin Peak securitization debt prior to an IPO or other transaction.

Looking to our other segments. In May, Round Table Pizza strengthened its presence in Texas with the opening of a second location in San Antonio. This development is part of a broader strategic partnership with Brame brands, notably this new San Antonio location marks the beginning of Brame Brand's commitment to establish 40 Round Table Pizza locations across the state underscoring the substantial growth potential we see in this market.

Our Fazoli's brand continues to gain momentum in Florida with the recent opening of our second Tampa location, bringing our total presence in the state to six restaurants. We've also bolstered – as always footprint in Arizona, launching our third location in the Greater Phoenix area with a new restaurant in Glendale. This location featuring a fresh brand look is off to an incredibly strong start, breaking Fazoli's opening weekend sales records. These strategic expansions reflect our ongoing commitment to grow in key markets and our confidence in the brand.

Co-branding also continues to be a key part of our strategy. Following the debut of our first Fatburger and Round Table Pizza co-branded concept last year, we've seen remarkable interest in the pairing with over 50 new locations currently under development. The success of this model was evident from its launch in Texas. And building on this momentum, we're thrilled to announce our expansion into Utah. Our newly announced deal will bring 12 co-branded Fatburger and Round Table Pizza franchised restaurants in Utah over the next six years, with the first unit set to open in 2025.

Our co-branded model of Great American Cookies and Marble Slab Creamery also continues to thrive. Over the last several months, we have continued to secure our foothold in Georgia, where we currently operate over 50 locations. Recently, the sister concepts opened four new locations in Georgia, namely Acworth, Bethlehem, Marietta and Snowville. Additionally, a stand-alone Great American Cookies opened in Columbus, Georgia. We continue to lean into strategic value offerings across our brands to drive customer engagement and traffic.

At Fazoli's we underscored the brand's long-standing value proposition during the July 4 holiday by offering \$4 [indiscernible] dishes then relaunching a fan favorite limited time offer, Pizza Baked Spaghetti at \$5.99. Both promotions reinforce our commitment to providing high-quality menu items at an affordable price point, a key pillar of the brand since its inception.

Similarly, Smoky Bones celebrated National Hamburger Day with an nostalgic promotion offering their signature cheeseburger platter for just 649 with the purchase of a beverage. The same price as when the brand launched in 1999.

To celebrate National ice cream day and ice cream month in July, Marble Slab Creamery offered \$5 off their ice cream cakes and a free small cup of ice cream with the purchase of another small or large cup on nationalized cream day. And on that day, we saw same-store sales up 3.8% over strong comparables from last year. Our brands continue to innovate and excite customers with new menu items and exciting partnerships. Pretzelmaker debuted Cheetos, Pretzel bites as a limited time offering. Fatburger and Buffalo's Express introduced a new collaboration with Frank's RedHot launching Nashville Hot Chicken Strips and Nashville Hot fries. And Hot Dog on a Stick announced its latest hand-stomped lemonade creation, Sour Patch Kids Watermelon lemonade. These initiatives across our portfolio demonstrate our ongoing efforts to keep our offerings fresh engaging and aligned with current consumer preferences.

Nontraditional venues, such as airports, cruise lines, amusement parks, universities and casinos represent a key area of growth. This type of expansion not only diversifies our revenue streams but also increases brand visibility in unique high-volume locations.

During the quarter, we opened a Round Table Pizza location at Stanford University in their student union and have further plans to build Round Table brand on campus in the coming months. In July, we also expanded our partnership with Royal Caribbean by opening our 15th location on their iconic ships, a Johnny Rockets on the newly launched Utopia of the Seas.

Moving on to our second strategic pillar, growth through acquisitions. We are assessing several new potential acquisitions that could add significant strategic value to our organization similar to how we targeted Smokey Bones to fuel growth at Twin Peaks and Nestle Toll House Cafe by Chip to boost our manufacturing facilities utilization. We're also looking at other categories to round out our portfolio, such as salad, sandwich or coffee brands.

When evaluating acquisition targets, we must ensure that the brand is both scalable and synergistic within our existing platform and when possible, leverage our existing manufacturing capacity, which brings us to our third strategic priority, leveraging our Georgia-based manufacturing facility. Our manufacturing facility, which produces Pretzel mix and Cookie Dough for our portfolio brands demonstrated strong performance in Q2.

While sales remained relatively constant at \$9.6 million for the quarter, the factory contributed \$3.8 million to adjusted EBITDA, an increase of 9.3% over last year's quarter. The plant utilization has improved from 33% at acquisition nearly three years ago to its current 45%, should additional demand materialize beyond what we could currently absorb, a modest \$1.5 million investment in additional equipment could double our capacity.

We also have 3.5 acres of unused real estate on site that can be expanded upon. This presents a significant growth opportunity for our factory business. To boost utilization, we have leveraged our portfolio of brands by enhancing our dessert offerings, selling cookies and other products made at the facility within our restaurants. Recently, we added dessert items across the Fazoli's locations and have plans to complete the rollout in our remaining casual dining and polished casual segments in the future.

FAT brand's foundation, I'd like to mention for a minute. I'd like to update you on the growth and work at the foundation. The foundation continues to make incredible strides with its grant giving. Through June, the foundation made 36 grants, which already has nearly surpassed the number of grants they were awarded in the full year of 2023, supporting many impactful nonprofit organizations.

We are also honored to share FAT Brand Foundation recently gained recognition from the Los Angeles Business Journal at its Annual Nonprofit and Corporate Citizenship Awards. Jessica Wiederhorn, the Foundation's President and also founding member was named non-profit Executive of the Year in emerging category by the LA Business Journal.

To conclude my remarks, FAT Brands continues to position itself for significant growth. Our business is built on delivering exceptional, authentic dining experiences across our portfolio, and we're uniquely positioned with the seasoned leadership team and a robust adaptable brand management platform that allows for efficient integration of new brands. Our strong and expanding development pipeline promises sustained growth for years to come.

We sincerely appreciate your participation today and your ongoing interest in FAT Brands.

With that, I'd like to hand it over to Ken to discuss our financial highlights from the second quarter.

Ken Kuick

Thanks, Andy. I'd like to now review our quarterly performance. Total revenues increased 42.4% to \$152 million driven by the acquisition of Smokey Bones in the fourth quarter of 2023 and revenues from new restaurant openings. Costs and expenses increased \$66.4 million or 75.2% in the second quarter. Included in cost and expenses, general and administrative expense increased \$19.6 million or 197.2% to \$29.6 million from \$9.9 million in the prior year period, primarily due to the Smokey Bones acquisition and the recognition of \$12.7 million in employee retention tax credits during the second quarter of 2023, partially offset by the recognition of \$2.1 million in employee retention tax credits during the second quarter of 2024.

Cost of restaurant and factory revenues increased to \$100.1 million compared to \$59.5 million in the prior year quarter, primarily due to the Smokey Bones acquisition and higher company-owned restaurant sales. Depreciation and amortization expense increased \$3.2 million to \$10.2 million from \$7.1 million in the year-ago quarter. Again, primarily due to the Smokey Bones acquisition, along with depreciation of new company-owned restaurant property and equipment.

Advertising expense varies in relation to advertising revenues and increased to \$14.7 million from \$11.6 million in the year ago period. Total other expense net for the second quarter of 2024 and 2023 was \$34.8 million and \$24.2 million, respectively, which is inclusive of interest expense of \$34 million and \$24.3 million, respectively. Net loss was \$39.4 million or \$2.43 per diluted share, compared to a net loss of \$7.1 million or \$0.53 per diluted share in the prior year quarter.

And on an as adjusted basis, our net loss was \$30.9 million or \$1.93 per diluted share, compared to net income of \$3 million or \$0.08 per diluted share in the prior year quarter.

And lastly, EBITDA was \$6.8 million compared to \$25.6 million in the second quarter of 2023. And adjusted EBITDA for the quarter was \$15.7 million compared to \$23.1 million in the year ago quarter. And as Andy mentioned, we received employee retention tax credits of \$12.7 million in the second quarter of 2023 versus \$2.1 million in the second quarter of 2024, a difference of \$10.6 million.

And with that, Kaylee, please open the line for questions.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Joe Gomes with Noble Capital.

Joseph Gomes

Good afternoon. Thanks for taking my questions.

Andrew Wiederhorn

Hi, Joe.

Ken Kuick

Hey, Joe.

Joseph Gomes

So somewhat of a similar theme with the first quarter, revenues were up nicely, but expenses were up even and more. And here in the second quarter, they grew even at a faster rate than they did in the first quarter. I understand part of that is due to the tax retention credits. But when do we think we'll start to see that kind of flex and where the revenue growth will exceed the expense growth on a quarterly basis.

Andrew Wiederhorn

Sure. I think you have to reconcile the difference in net loss or adjusted net loss from Q2, a year ago to Q2 2024. There's really five or six components. One of them is interest expense. One of them is the tax credits. One of them's depreciation and then you have some net income losses from the Smokey Bones acquisition and a little bit from Fazoli's and Round Table Pizza, where Round Table, we own some corporate stores that were sold to no longer have that income. And you put all that together and it gets you to that difference between the \$32 million difference basically. As we see the refinancing of Twin Peaks and hopefully, the public company listing of Twin Peaks, that will peel some of that off of the FAT Brands platform that will also create an opportunity to raise equity and reduce interest expense in total.

And so that's going to be a key driver because Twin Peak sits at approximately \$400 million of debt to reduce that debt with equity raise will substantially affect that number. The second thing is, of course, the pipeline of new store builds that adds somewhere between \$6 million and \$10 million a year of incremental royalties, depending on which brand and how many units get opened. So I think that's – those are the two things. And then finally, of course, legal expense has to end here somewhere, maybe 12 to 18 months from now, and that will be the final touch of it.

Joseph Gomes

Okay. Thanks. But Andy, you talked about the new store development here. So in the second quarter, you had projected that you're going to open, I think it was 40-some-odd stores on the first quarter call, you project, you're going to open, I think 40-some-odd stores here in the second quarter. And obviously, we fell short of that you still seem to think you can come up to that 120-ish for the full-year. Anything in particular that has caused the rate of store openings to kind of slow down from our initial expectations?

Andrew Wiederhorn

So there's a couple of things that contribute to it. One is that you just generally have franchisees dragging their feet just a little bit, just a little slower to get things done, whether that's financing or whatever that they're applying. But they are on track to open. I mean we have scheduled opening dates through the end of the year for those remaining 80-something stores, 75 stores and 20 or 30 of those are international, where they're very much on track to open in their multiunit repeat operators so they don't need a lot of assistance from corporate. So we feel pretty good about these dates, but you never want to be in December opening new stores. So we really want to get them open as many as we can before Thanksgiving, and we have an awful lot scheduled. So we feel pretty good about it.

Joseph Gomes

Okay. And then one more for me, I'll jump back in queue. You talked about M&A and you still are assessing some opportunities – you mentioned the same thing in the first quarter call. Are these the same opportunities or new opportunities come about here? You have seen a little bit of ups and downs here recently in the restaurant industry. I was wondering if there's been maybe an opening, so to speak, of people looking to come to somebody like you, a consolidator and be more open on price that maybe some of that has started to percolate.

Andrew Wiederhorn

Definitely, the latter, we're seeing more deals than ever right now and certainly than we did last year, and we're seeing sellers with reasonable expectations. And so I think that there's an opportunity to make acquisitions similar to sort of the pricing around like Smokey Bones, where it was in the 3x to 4x cash flow range versus stuff that – where people are still trying to hold out for 7x to 10x and it's just hard in this environment to justify that.

We want to see from a consumer trend standpoint, we want to see the election behind this, and the interest rate cut is behind us, and that would create some momentum I think, as well. But I think from a pure M&A standpoint, there are opportunities out there. They are delevering opportunities, meaning that we could add EBITDA and cash flow at a much lower rate than our leverage rate today. So that's an interesting opportunity for us as a way to delever the balance sheet and add to our scale.

Joseph Gomes

Great. Thanks, Andy. Appreciate it.

Andrew Wiederhorn

Thank you, Joe.

Operator

Your next question comes from Alton Stump with Loop Capital.

Alton Stump

Great. Thank you. Good afternoon, Andy and Ken. I just want to ask first off on the same-store sales being down only 1.6%, held flat on a two set basis sequentially versus the first quarter. I'm sure you guys have all read, all of the negative news out there and for those that has come out with earnings, it probably going to be one, if not the only one out there that actually kept to your stacks unchanged in 2Q versus the first quarter.

Clearly, you guys own, obviously, almost 20 different concepts. You've got a lot of different things going on for each concept. But was there any handful of sort of key outperformers in your portfolio that you think enabled you to hold that to your stack trend flat in what was obviously a very challenging quarter for the overall quick-service industry.

Andrew Wiederhorn

Yes. The burger segment has been very solid. Fast Casual segment has been very solid. And the snack segment has been very solid as well. Where you see – where we've seen – what other people have seen, which is on the QSR side of things, your traffic is off and your sales are off, your topline sales are off, we have company-owned stores in that bucket. So it affects you harder and that consumer just doesn't have anywhere to go. And so you've got to focus on value and try to focus on frequency and make sure that you're driving profitable value opportunities, you're not cannibalizing sales and trying to drive traffic where you're actually losing more money.

So we've been focused on that, but we've definitely seen it there. So it's kind of interesting to see how snack brands and how the fast casual brands where burgers and their average checks can be in the low \$20 are doing pretty well, and you've got other pain thresholds where it's a higher pushback. We've also seen, for example, our Ponderosa and Bonanza Steakhouse brands have just consistently been up mid to high single digits. And I'm sure that's a value proposition of an all you can eat steak and all you can eat buffet at a pretty good value price. So to see those up strongly is nice. We've seen in the past casual segment, Same-store sales are off just a little bit and a lot less than they were off as we started the year.

So we've had a very good recovery in that – in those segments or that segment. And we anticipate getting better and better after we get out of the dog days of summer here. There's not a lot of sports that drive people to sports bars in over the next few weeks, and then we'll be back into football and everything should be great again. The Olympics don't actually drive people. People don't go to the sports bars to watch the Olympics as much as they do it at home and it's also the time change. So I think that's the solution. But we do – we are pretty optimistic about the second half of the year now for the polished casual segment.

Alton Stump

Great. That's great color. Thank you for all that. And then I guess just one other follow-up and I'll hop back in the queue, but you obviously are just now underway with your first conversion of Smokey Bones to a Twin Peak. So it's all very early. I actually understand. But how has that gone so far? And have you learned anything yet that could help you sort of as you look to accelerate that conversion process, as you mentioned, not just over the course of the back half of this year but into the next couple of year period.

Andrew Wiederhorn

Yes. Well, Joe Hummel, our Twin Peak CEO and his team are pros at conversions of second-generation restaurants they say, probably 75% of the Twin Peaks restaurants that existed today are second-generation restaurant units. So very, very focused on how to do it quickly and efficiently. This Lakeland, Florida location will be up and running in under nine months. So we're very happy with that. When we bought Smokey Bones in Q4 of last year, our franchisee base and even for corporate stores, we had already picked out most of the 2024 new stores to open, franchisees have already purchased land or building buildings or lease new locations.

Same thing with corporate. We had three or four company-owned stores under construction or development. So the timing of the conversions of the Smokey Bones is really a 2025 and 2026 event, just because 2024 everybody already had all – they played full with all the stores they could open. And remember, these stores take up a lot of money to open. It can be anywhere from \$3.5 million, \$4 million on a conversion of a store to \$7.5 million to build a brand-new store.

And so you can only ask a franchisee to write so many checks at a time in a given year, and they planned their cash flow for that purpose and same with corporate. So we feel good about it. We're excited for the momentum. When you see the brands that get the best valuations and the biggest part of the multiple expansion here right now, it's brands with high unit growth and certainly Twin Peaks has high unit growth planned for the next three years.

So does FAT Brands having 2,300 restaurants open another 1,100 in the pipeline, paid for by franchisees and on the schedule to build them. So we really feel like being a franchise, we're having high unit growth executing on that unit growth should really see some of the stuff get behind us here. And of course, as we refinance our different securitization transactions over the next 24 months, we think that we'll still see savings there as well.

Alton Stump

Clear. It makes sense. Thank you. That's helpful. I will hop back in the queue.

Andrew Wiederhorn

Thank you, Alton.

Operator

This concludes our question-and-answer session. I would like to turn the conference over to Andy for any closing remarks.

Andrew Wiederhorn

I just want to thank all of you for joining the FAT Brand's conference today, and we look forward to updating you further on our Q3 earnings call and hopefully some exciting stuff to talk about at that time. Thank you very much, operator.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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