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EPS of \$0.06 **beats by \$0.03** | Revenue of \$53.86M (15.90% Y/Y) **beats by \$2.24M**

GEN Restaurant Group, Inc. (NASDAQ:[GENK](#)) Q2 2024 Earnings Conference Call July 31, 2024
5:00 PM ET

Company Participants

Thomas Croal - CFO

David Kim - Co-CEO

Conference Call Participants

Jeremy Hamblin - Craig Hallam Capital Group

Todd Brooks - Benchmark Company

George Kelly - ROTH Capital Partners

Operator

Greetings, welcome to GEN Restaurant Group 2024 Earnings Call. [Operator Instructions] Please note this conference is being recorded. I will now turn the conference over to Tom Croal, CFO. Thank you. You may begin.

Thomas Croal

Thank you, operator, and good afternoon. By now, everyone should have access to our second quarter 2024 earnings release. If not, it can be found at www.genkoreanbbq.com in the investor relations section.

Before we begin our formal remarks, I need to remind everyone that our discussions today will include forward-looking statements within the meaning of federal securities laws, including but not limited to, statements about growth plans and potential new store openings, as well as those types of statements identified in our quarterly report on form 10-Q for the period ended June 30, 2024 and our subsequent reports filed with the SEC.

These forward-looking statements are not guarantees of future performance and therefore you should not put undue reliance on them. These statements represent our views only as of the date of this call and are also subject to numerous risks and uncertainties that could cause actual results to differ materially from what we currently expect.

We refer you to our recent SEC filings, including our quarterly report on form 10-Q for a more detailed discussion of the risks that could impact our future operating results and financial condition. Except as required by law, we undertake no obligation to update or revise these forward-looking statements in light of new information or future events.

During today's call, we will discuss some non-GAAP financial measures which we believe can be useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with GAAP.

Reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures are available in our earnings press release and our SEC filings, which are available in the Investor Relations section of our website. Now I'd like to turn it over to our Board Chair and Co-CEO, David Kim.

David Kim

Thank you, Tom, and good afternoon, everyone. In the second quarter, we continued executing on our strategic growth initiatives to expand GEN's geographic coverage and overall market share.

This quarter, we delivered another strong revenue performance, achieving a 16% year-over-year increase in total revenue for the second quarter in a row, while delivering our restaurant level adjusted EBITDA margin ahead of our expectations at 19% due to operational efficiencies.

I'm proud to say that we exceeded nearly all consensus estimate as we continue to deliver on the strategy we've laid out. With the sustained profitability of existing stores, strong revenue growth from new stores, and ongoing cost optimization initiatives, we're well positioned to continue executing through the remainder of the year.

For those new or newer to our story, I always like to start these calls by giving you a recap of who GEN Korean BBQ is, what differentiates us, and why our model positions us for sustainable future growth.

GEN Korean BBQ is an all you can eat, full service, cook it yourself at your table casual dining restaurant concept that offers consumers a variety of best in class proteins as well as salad alternatives across both lunch and dinner at affordable, all-inclusive price.

Our unique business model both optimizes and minimizes kitchen staff and space, allowing us to offer consumers an exceptional dining experience at an incredible value, which is our core proposition.

Going forward, we expect our proven model to generate, at least on average, a cash-on-cash return of 40% in a payback period of approximately two to two and a half years, driven by an average of \$4 million to \$5 million in annual unit volume and restaurant level adjusted EBITDA margin of 18% to 20%.

It's worth noting that our payback period includes pre-opening costs. If you were to exclude these costs, as some of our other peers do, we are at an even more attractive level of less than two years. For further context, our ten most recent new restaurants are showing 2.5 years payback and getting better.

Overall, we're bullish on the long-term potential of our concept. Further underscoring our confidence is the increasing popularity of Asian dining concepts across the Millennial and Gen Z age group.

In fact, we've seen ample press coverage over the past several months on this very topic. Reputable outlets such as Nation's Restaurant, Muse, FSR, CNN and others have all cited this shift towards Asian focused cuisine, driven by both changing ethnic demographics and younger audience seeking new and unique flavor profiles.

We are proud to be at the forefront of this emerging trend and believe we have the necessary expansion strategy to place in place to continue introducing our unique and innovative concepts to many new customers.

Now, let's dive into our restaurant development. In the second quarter, we opened new restaurants in Jacksonville, Florida, bringing our total stores for 2024 up to three. We also began construction on seven additional locations across the country.

We expect to open one restaurant next month and the remaining six by the end of the year or sooner. As a result, with these planned new locations making significant progress towards opening, we're adjusting our guidance from eight new restaurants to ten to eleven new restaurants for 2024.

In addition to the ten to eleven restaurants in 2024, we have eleven or more locations with leases either being signed or in the process of being signed. Also, we have 15 to 20 additional leases and negotiations which should lead to our 2026 projections.

We're raising the bottom end of our guidance for the end of 2026 and now expect to have 75 to 80 locations. Looking ahead to our overarching expansion roadmap, we're experiencing strong momentum and maintain high confidence in achieving our long-term growth goals.

Moving forward, our robust pipeline of new restaurant openings and lease agreements reflect our confidence in scaling our footprint and achieving our growth targets. With a solid foundation, a profitable operating model and a healthy balance sheet, we're achieving sustained success and are committed to delivering significant value to our shareholders in the years ahead.

Thank you for your continued support and partnership on this exciting journey. I would now like to turn the call over to our CFO Tom Croal to discuss our second quarter results in more detail.

Thomas Croal

Thank you, David. For the second quarter, revenue increased 15.9% to \$53.9 million compared to \$46.5 million in the second quarter of 2023, driven primarily by new unit openings, including our latest location in Jacksonville. I'd like to touch on how the broader economic landscape is affecting our customers and what we experienced in the second quarter.

Overall, consumers are certainly feeling the pressure of persistent inflation, causing them to be more aware of their spending. While other macro data such as employment rates and wage growth aren't signaling any long-term concerns, softer consumer spending impacted the restaurant industry as a whole this quarter.

GEN is not immune to these trends and we did experience a 5.6% decline in same store sales growth. We have locations generating both positive and negative same store sales comps, but the negative decline was primarily driven by five underperforming locations.

Without these five locations, we would have generated a positive same store sales figure through June 30. Two of these restaurants have had three to four new competitors open up in the area and one restaurant was impacted by a new restaurant we opened in the same area.

However, it's important to note that while these locations are offsetting the overall same store sales figures, they are all well within our internal profitability targets and contributed \$4.4 million of restaurant level EBITDA during the six months ended June 30. It would be foolish to shut down any of these five restaurants just to improve our same store sales.

Further, with only 33 restaurants in our same store analysis, the sample size is too small to get any clear indication. Our next 10 to 15 restaurants will be outside of California, which should normalize our same store sales ratio in the future.

We are also constantly evaluating our menu options and introducing new items to keep the experience fresh for new customers while ensuring we remain on top of broader consumer trends. We recently introduced our premium menu, for example, has created single digit sales comp improvements at several of our restaurants.

We'll continue to look for further opportunities to drive customer interest while also improving our financial performance. Turning to expenses, cost of goods sold as a percentage of company restaurants sales increased year-over-year by 110 basis points to 32.9%, largely due to slightly higher food costs associated with the implementation and integration of our premium menu.

Cost of goods sold declined 50 basis points on a sequential basis compared to the first quarter of 2024. Payroll and benefits as a percentage of company restaurant sales decreased 40 basis points year-over-year and decreased 140 basis points sequentially to 30.4%.

Occupancy expenses as a percentage of company restaurant sales increased by 20 basis points year-over-year to 8.1% because of new restaurant openings over the last twelve months. On a sequential basis, occupancy expenses as a percentage of restaurant sales declined by 20 basis points from the first quarter to the second quarter.

Other operating expenses as a percentage of company restaurant sales increased 60 basis points year-over-year to 9.9%, but decreased by ten basis points from the first quarter of 2024. Overall, we are tightly managing our costs throughout the organization and pleased with our sequential decreases across the board.

Adjusted restaurant level EBITDA as a percentage of total revenue was 19% for the quarter compared to 20.4% in the second quarter of 2023. The year-over-year decline was primarily due to the previously mentioned increase in costs.

Most importantly, though, I'd like to highlight that adjusted restaurant level EBITDA improved sequentially by 240 basis points compared to the first quarter of 2024 as we continue to focus on this metric through operational efficiencies.

G&A during the second quarter was approximately \$4.3 million or 8% of revenue, excluding stock-based compensation, which is consistent with our first quarter 2024 results. The year-over-year increase in G&A is largely due to the addition of new personnel needed for new restaurant development along with public company costs which weren't present in the second quarter of 2023 because we were a private company.

Since we went public in June of 2023, our third quarter of 2024 will be the first quarter that is comparable on a year-over-year basis. Adjusted EBITDA was \$4.9 million, net of pre-opening costs compared to \$6.3 million for the second quarter of 2023, while adjusted EBITDA decreased year-over-year, primarily due to increases in G&A that I just mentioned.

Our second quarter adjusted EBITDA came in higher than indicated by estimates. Without pre-opening costs, adjusted EBITDA would be approximately \$6.5 million. Our net income was \$2.1 million compared to net income of \$4.5 million in the second quarter of 2023.

This decline is driven by the same factors I mentioned earlier, primarily due to increased G&A. Turning to liquidity, as of June 30, we had \$29.2 million in cash and cash equivalents and we carried no long-term debt except for \$5 million in government funded EIDL loans, which we had when we went public.

We also have \$20 million available in our revolving line of credit, although we incurred \$8.4 million of development costs and additionally paid \$3 million for the purchase of the remaining ownership of our Hawaii business during the first six months of the year, for a total of \$11.4 million spent.

Our cash only decreased by \$3.4 million from \$32.6 million at December 31 to \$29.2 million at June 30. Our cash flow has been so strong that we've been able to internally finance almost all of our development without having to use cash or debt. Since we went public in 2023, we have funded \$21 million in development costs without depleting our cash balance or incurring any debt.

As I've said before, I'd like to restate that GEN continues to generate strong free cash flow, a trend we anticipate continuing throughout the remainder of the year. This concludes our prepared remarks. We'd like to thank you again for joining us on this call today and we are now happy to answer any questions you may have. Operator, please open the line for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question is from Jeremy Hamblin with Craig Hallam Capital Group. Please proceed.

Jeremy Hamblin

Hi. Congrats on the strong profitability here. I wanted to just ask a little bit deeper on the same store sales trends and a little bit of a softening here that you're seeing. Can you give us a sense for the cadence of same store sales trends during the quarter and then how things have started off here to start Q3?

David Kim

Okay, so you're talking about after the quarter, June 30, right?

Jeremy Hamblin

Yeah. Just to clarify, you know, get a sense for during the second quarter, which months were your strongest and kind of the magnitude of that? And then how things have started out here in July?

David Kim

So, April started off pretty strong, and then it started to taper down. July has not started strong. It's tapered down. But I want to reiterate our position of negative comp. Right now, we don't have enough sample sizes.

We are concentrated close to 50% in one region, which is California, and the rest is spread out. The subsequent openings that we have going forward for the next two years is probably all outside of California.

Maybe one store in San Diego coming up. So, what does that mean? California is probably the most that's impacted in terms of sales. But in our case, it's not all restaurants that are all negative. We have positive ones and negative ones. But when we started to go into a lot of details, five of the restaurants which were high volume restaurants were impacted a lot due to competition.

When there are stores that open three to four stores in your immediate neighbor or immediate area, by default, each new competitor is going to chip away sales in small increments. So just by default, if one opens up, we'll probably lose 3% to 5% and, you know, they add up.

So, at this time, as a company, we're not too concerned about the negative comps because it's not an even spread-out issue here. So, as we open up more restaurants, when we get to closer to the 80 or 100 restaurant, we'll have a better view of what the negative or the positive comps are.

And I like to reiterate again, another subject here is, as a company, as a philosophy, it is not going to change. We're going to continuously make profits. We're going to continuously use the cash flow to grow. And our concept is to take off and return our internal rate of return to try to achieve between two and two and a half years.

And that model will not change, and we'll continue that process here. So, yes, we are concerned about the softening of consumers behaviors, but we're dealing with those issues with combating with new product and new drinks.

And there's some other things that we're doing now that we haven't really pulled the street yet. We are not going to announce it until we actually test it and see what the results are.

Jeremy Hamblin

Great. Helpful color. I also wanted to ask about one of those new things, in terms of the premium menu, which I think in June you launched across your chain. What is the attachment rate? What is the, the portion of your orders that are coming from the premium menu or kind of that \$20 upsell that you're getting in your restaurants?

And how is that performing, let's say, in larger markets versus, let's say, smaller or lower income markets? Is there any notable difference?

David Kim

We haven't seen notable difference in certain markets other than we have restaurants that are it makes up 2% more in sales. Some stores make up 10%. It's very inconsistent right now, but one of the consistencies, again, we just only saw it in one restaurant.

We'll find out more when we open the other one next month. Is the practice of upselling, as a company's culture we were so focused on turning tables, we did not have a product line to train our staff to suggest these different higher priced products.

So, when we introduce and roll out these higher priced products, we had a little issue with our staff actually following through the upselling process because they weren't used to it. So we are still going through that process now.

We're not nowhere close to executing that practice, but the ones that have come on board and followed our process to upsell and train staff and stay on top of staff, they actually are showing better results. Therefore, we are putting a lot of focus these days on training our staff to do more upselling of these new higher end products.

Jeremy Hamblin

Great. And then last one, just related to the premium menu. I noticed that your cost of goods sold sequentially improved in Q2 versus Q1, but a bit more degradation to the food cost margin in Q2, which you noted was related to that, the kind of the uptake in the premium menu. I would imagine that maybe there's some on a go forward basis, some scale advantages related to rolling that out to the entire chain.

But in terms of thinking about food cost going forward here for the remainder of the year, is that something where you feel like that's kind of settled into a more targeted area in terms of your margin profile?

Do you feel like the premium menu pricing is at the right price point, or is there any potential for experimentation around that?

David Kim

We think there is more room for experimental around that. At this point, it is still not very clear because of the inconsistencies throughout the restaurant. So, when we get more consistencies, we can kind of find that we don't see any uptick in food cost in the future at this point.

So, yes, quarter-to-quarter, we've been improving, but we still have some areas to improve if we compare to last year. So, we're still experimenting in some areas right now.

Jeremy Hamblin

Great. Thanks for taking the questions. I'll hop out of the queue.

Operator

Our next question is from Todd Brooks with the Benchmark Company. Please proceed.

Todd Brooks

Hey, thanks. Good afternoon, gentlemen. If we can start on, and you rightfully made the point that x one data point, you guys really outstripped consensus expectations for the quarter, I wanted to dig in on with the same store sales performance coming in down in that 5.6 range, how well are the non-California markets performing to plan to allow you to deliver the revenue upside that you did?

David Kim

Is your question pertaining to the existing stores that have the one year-over-year comparison or the brand-new stores we just opened?

Todd Brooks

Really, I'm talking about the total, the total base, David. So, I know that the comp base is largely California located, but I know that the total sales result was substantially above what people were looking for in estimates. So, you more than offset the kind of greater than expected comp weakness.

What has to be strong performance in the stores that aren't in the same store sales base yet?

Thomas Croal

Yeah, that, Todd. That's right. We've done very well at our new restaurants that have opened up during the last year. And of course, everyone is a little bit different, but overall, as a group, they're above expectations, and that directly is impacting our ability to beat the numbers.

Todd Brooks

Okay, great. Thanks, Tom. And then a second question. If we think about the impressive kind of lift in margins that you saw, getting back to that 19% level in Q2, it sounds like from the quarter to date, qualitative commentary that you gave David that we haven't, we've seen a little bit more of a degradation in same store sales performance.

But how sturdy should that margin be in the second half, knowing that you guys are working diligently on the cost side of the equation?

David Kim

Our target is still 20% for a wall. And we are marching towards that now as we get closer and we're getting very in detail, looking at every aspect of this, it's not, it's harder to gain a percentage, but we think we can get there.

Okay, can we get to 22%? No, but can we get to 20%? We're very close.

Todd Brooks

Okay, great. And then the final one for me, it looks like you found sources of labor efficiency during the course of the quarter. GEN is a growth company. You need bodies to help fuel that growth. I guess, where have you found efficiencies that you've extracted on the labor line, and how sturdy are those going forward as you continue to grow? Thanks.

David Kim

So, two ways. There's always areas to improve, okay? Because we are net focused in the day-to-day operations. But besides that, as we grow outside of California, California being the most expensive state for labor, as we open more restaurants outside and the ones that we already opened are coming in line to compare, the labor costs will by default go down because other states are lowered in southern California.

So, when the Southern California, let's say, store, becomes 25% of the overall company, not 50%, our labor costs by default will get better.

Todd Brooks

Okay, great. Thanks for the color, David.

Operator

Our next question is from George Kelly with Roth MKM. Please proceed.

George Kelly

Hi, thanks everybody, for taking my questions. Hi, David. So maybe to follow up on that last question, David, if you could, I'm curious, as you open restaurants outside of California or really focus outside of California, like, could you highlight the different sort of unit level economic profile, like what do you expect, one of these new restaurants in a place that you're more focused now, be it Florida or Texas versus one of your legacy California restaurants?

How does that unit economic profile differ?

David Kim

We, we were looking at that too intently. But actually, you know, we have low volume stores in, let's say, Florida, but the low volume stores that we were talking about last year, they all came up in sales and EBITDA. So, we're saying, well, maybe outside of California it's taking a little longer to get the sales up because it's less known.

But some areas, like in Texas we opened and sales are very high. So, there's no like specific areas where we can pinpoint is good and bad. Seattle, tremendous amount of sales that we're doing. Didn't expect that. So, it's all over the map right now.

So, we're maybe looking at to see is it site selection that we have. Okay. That we have an issue on the low volume versus the high volume. Our criteria hasn't changed. So again, not enough sampling right now and we are going into some new areas next and the first quarter of next year, we should start building those out and see how they perform. But it's not consistent.

George Kelly

Okay, understood. And then next question still on new openings. So if you're able to execute on your updated guidance, call it 10 this year, that gets you still right around 30 shy of where you expect to be the midpoint of your year in '26 guidance that you just mentioned, the 75 to 80.

And so, I guess the question is, what is the kind of cadence of openings next year? And in '26, I mean, should it be 15 openings next year? And then the second part of the question is where I'm sure you have a pretty good view right now of your '25 openings at least.

Are there geographies where you're expecting to really focus on and densify? And what are those, if you don't mind sharing?

David Kim

Sure. To answer the second question, we are opening in areas that we're very strong in with sales and EBITDA. So, we'll continue to grow those areas. So for example, let's say for every four existing markets, we'll open one new existing. Okay. Because we still have to plant the, plant something in areas that we're not there yet, but we are going to focus on.

So, all these openings are in areas that we are doing well in and then a small portion of that will be new areas. So, I think I've answered that question. What was the first question again? I apologize, George.

George Kelly

So, this year, if you end with just shy of 50 restaurants, that still leaves you like almost 30 for the next two years. And I'm just curious, will it be 15 next year? Like how many openings should we expect next year?

David Kim

I think we'll on the next call, when we give our guidance for 2025, we were going to announce 11 or 12, but we have more than what our, so like for example, next course, why we are able to let you know that we can open so many stores by the end of the year is because once we start construction, then we're in a lot control of the destiny of when these restaurants can open.

But up to getting the building permit is where we don't have a lot of control because it's controlled by a government agency. Having said that, we were going to announce maybe 11 or 12, but we have a lot more that we are negotiating with landlords than what we are telling the street of 75 to 80.

We'll probably do more than that. But right now that's a number, conservative number where comfortable with as of today.

George Kelly

Okay, understood. And last question for me is just on your fiscal year '24 guidance, you last quarter gave us revenue and four wall margin guidance. And I didn't hear any kind of update on the, in your prepared remarks.

Just curious if there's any kind of update?

Thomas Croal

Yeah, I think at this point on the revenue side, we're sticking with our range that we gave before, probably closer to the higher end of the range. And then on the margin we said we would be approaching 18%. We're already there, obviously.

So, we're doing a little bit better. But as David said, the goal is to get to 20% and we're working as hard as we can, as fast as we can to get there.

George Kelly

Understood. Thanks.

Operator

We have reached the end of our question-and-answer session. I would like to turn the conference back over to Mr. Kim for closing remarks.

David Kim

Thank you very much for being on this call. We are just very focused in what we do. So yes, there's, there are issues out there, political issues with consumer spending, but we're not deviating from what we said we will achieve.

So, thank you very much for listening and believing in us.

Operator

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

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