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Noble Roman's, Inc. (NROM) CEO Scott Mobley on Q2 2019 Results - Earnings Call Transcript

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Noble Roman's, Inc. (OTCQB:NROM) Q2 2019 Earnings Conference Call August 15, 2019 4:00 PM ET

Company Participants

Scott Mobley - President & Chief Executive Officer
Paul Mobley - Executive Chairman & Chief Financial Officer

Conference Call Participants

Scott Mobley

Today we will discuss second quarter results and other company developments and we greatly appreciate your participation today. My name is Scott Mobley and I'm President and CEO of the Company. With me is Paul Mobley, our Executive Chairman and CFO. We'll begin today's call with the recap of the financial highlights, then move into a brief discussion of other developments. Following the presentation, we'll open the call to questions.

Before we get started, I'd like you to refer to the Safe Harbor statement contained in the earnings release. This conference call may also contain forward-looking statements. So the provisions of that statement apply to this conference call as well.

Okay. Well, with that bit of housekeeping out the way, I'll turn it over to Paul and he can discuss the financial highlights from the quarter. Paul?

Paul Mobley

Good afternoon everyone. The good news is, we had another good quarter and good year despite the various obstacles that we have encountered this year, starting with the highly unusual severe winter weather in January and February, an extremely tight labor market, increased competition in a number of stores and overall restaurant sales in general having a slightly sluggish summer.

I do not intend to go through the entire press release, as I assume you all received it and read it. I'll hit the highlights here and we'll be available later for questions. Net income before taxes was $580,000 or $0.03 per share and $121 million or $0.06 per share compared to 550,000 and $0.03 cents a share or $1.09 million or $0.05 a share for the three month and six month periods ended June 30 compared to the comparable period in 2018.

Net income before taxes are very important in our situation, as we will not be paying any income taxes on approximately the next $15 million in taxable income due to our deferred tax credits. Net income was $441,000 and $0.02 per share or $917,000 and $0.04 per share compared to $412,000 and $0.02 a share or $815,000 and $0.04 per share for three month and six month periods ended June 30 compared to comparable periods in 2018.

A very bright spot in the results from last quarter was the margin contribution from the franchising venue increased to $1.1 million or 66% of its revenue from 950,000 or 58% of its revenue and increase to $2.2 million or 67.6% of its revenue from $1.8 million or 58% of its revenue for the three month and six month periods ended June 30 compared to the comparable periods in 2018.

Total revenue from franchising increased slightly to $1.34 million from $1.28 million and from $2.62 million to 2.3 -- and to $2.6 million from $2.39 million for the three month and six month periods. However, the increased revenue from franchising was partially offset by some decrease in royalties and fees from grocery stores, reflecting the company's decision not to focus on grocery stores at this time, as it tends to be countercyclical in nature. So the company made the decision that its efforts would be more productive on franchising during a good economy, this move also contributed to that margin increase.

A significant portion of the margin increase in the venue came as a result of the company taking an in-depth review in January to find ways to further reduce its costs, while still accomplishing its objectives. As a result of this action, total operating expenses for the franchising venue were reduced to $545,000 from $685,000 and reduced $1.04 million from $1.33 million for the three month and six month periods. These structural changes are expected to continue to benefit future periods as well.

The contribution margin on Craft Pizza & Pub declined to $209,000 or 15.7% from $282,000 or 22.6% and declined to $234,000 from $525,000 for the three month and six month periods ended June 30 compared to the comparable periods in 2018. The margin decreased despite the fact that the most – that the most variable costs such as cost of sales, costs of labor improved to 49.5% from 52.5% and improved to 31% from 53% for the three month and six month periods. The salary portion of labor costs is not variable. So the improvement in the above cost is not as great during the six month period as it was during the three month period, because of the poor sales in January and February.

Facility cost however, including rent, common area maintenance and charges, and utilities were the largest contributor to the decreased margins, primarily the result of increased common area maintenance charges by the landlords. In 2018, all four locations were operating in new strip centers where common area maintenance fees were based on landlord's estimates for those costs, either through lack of controlling their costs or poor estimating, the actual costs came in much higher than the estimate, and in two cases it was action more than double. Therefore, the 219 common area charges are based on 218 actual.

Over the years of leasing shopping center space, I have never encountered landlords missing their estimate of common area charges by the magnitude they have in this case. I yet do not know, whether they were putting out low estimates to appear more attractive, or they simply were not controlling their costs. The landlords involved certainly, know my feelings about the increase and we will be noticing them to audit – for audit of the common area charges records very soon.

The company experience from those costs increases such as delivery fees starting in third-party delivery service in January, to partially offset the sales effect of inclement weather, despite the remove – reduced margin the second quarter margin was still great enough to allow for a great return on investment from these restaurants. However, our challenge remains in the future to chip away at the fixed costs and target our advertising toward broadening our demographic appeal to increase sales volume.

General and administrative expenses remain tightly controlled about the same for both periods. Interest expense increased to $220,000 from $153,000 and to $347,000 from $314,000 for the three month and six month periods. The increase was the result of increased rate of interest on the company's bank debt, which was partially offset by the decreased loans balances from continued monthly amortization of principal.

With a focus on development in the company's franchising venue combined with the new catalyst for growth represented by Craft Pizza & Pub, we firmly believes this re-entering the potentially most exciting expansion phase that we've yet to experience in our long history.

In support of this growth opportunity, the company believes it may soon have financing in place to repay all existing debt, have additional debt capital for the development of another five company-owned Craft Pizza & Pub locations, all at considerably lower rates of interest than it's currently being paid.

I will now turn back over to Scott.

Scott Mobley

Okay. Well, thank you, Paul. I'll now discuss the few recent developments in our two growth areas. First of all, turn our attention to the non-traditional venue, we've now open in 21 locations so far this year, and we have a number of more than that in the queue ready to open. And that's compared to 17 openings at the same time last year. If you're in attendance at our annual shareholder meeting in July you already know that one of those recent openings set a new sales volume record for convenience store locations.

It's an interesting story, because that location is in the Navajo Nation in a town called Red Mesa, Arizona. The official population of Red Mesa, Arizona is only 480 people, and there's not a single other major population center nearby. Not only Noble Roman's selling pizza's in Red Mesa's, the only Pizza option for miles, and miles, and miles in every direction. I point this out, because it really illustrates the fact that our non-traditional locations can do extremely well in underserved smaller communities located virtually anywhere in the country.

The banks was not the only higher volume non-traditional unit we opened this year. It's worth noting that the average volume of new non-traditional locations, in general, this year 2019 is exceeding that of previous years by a substantial 32.8%, that's pretty phenomenal, keeping hiring in advance with new units has been a key goal this year as a direct result of changes we've made to kiosk design, marketing, and system. Coming out soon, we're going to be implementing a few new products into the non-traditional venues that come out of R&D.

These products were focused on our breakfast menu extension which is a key part for our convenience for our franchisees. These new menu items are going to include French toast sticks, chicken breast biscuits, and the low-meat breakfast sandwiches. I expect that all of these options will be available on our menu and throughout the system in the early fourth quarter.

So, turning our attention to Craft Pizza & Pub, we just completed the roll out of our seven new baked sandwiches that we baked subs previously on the menu. This roll out was part of a larger projects to improve our lunch date part. Other changes for that day part included new combo meals, side items, and a large salad.

All these changes have been implemented and now that we have some runtime under our belt for using ancillary marketing tactics to ramp-up and get the word out. These efforts involve distributing menu packets to area businesses around each location on a daily basis.

In fact, by the end of September, we hope that 4,000 of these packets distributed around each store, each restaurant and they'll include carry out menus, combo flyers, coupons, and our [Indiscernible].

Along with the new sandwich introduction, our second pepperoni option is now on the menu and available at all locations. We call it crispy kernel pepperoni which pretty well describes what it is.

In contrast to our classic pepperoni, which bakes flat and soft, has a traditional flavor, crispy grilled pepperoni is smaller in diameter and bakes into a cup-like shape that is very crispy in texture. These two pepperonis will be featured in the September French promotion on a longer time only pizza that we call Primo's Pizza Perfection. It has both classic and crispy grilled pepperoni as well as bacon. While pepperoni is the number one topping in the country, we think this longer time pizza special should be very positive.

Also recently completed this rollout of online ordering system. All company-operated units are currently active on the system and are starting to include it on ordering options with our print advertising.

The introduction of Grubhub a second third-party delivery option store Dash has also been completed. Again it's important to note that we did not actually advertise our participation with these third-party delivery services. We allowed the business to grow organic only through the third-party ordering ecosphere.

The goal is to capture a younger demographic so much as ordering either online or directly through these third-party systems and converting our existing carry out traffic.

In other words, you won't find mention of the Grubhub or Dash in our restaurants on our advertising or on our website. And speaking of our traffic on popular website, we'll have a new website rolled out and going live within a week or two replacing the current one and I believe that will be a strong improvement.

During the last call, we discussed the possibility of moving towards split pricing on our pizza crust charging a small premium for a signature [Indiscernible]. We have in fact now implemented this change with the recent additional menu changes.

Our experience and our analysis show that this Sicilian piece is perceived as a premium product and demand-resistant pricing changes within reasonable tolerances. The premium charge is relatively small, charging an extra $0.25 for an individual sized, $0.50 for a medium, a $1 for a large. There has been no adverse reaction to this change and it should provide a small boost to our continuing efforts to positively impact good cost.

Next quick update on our Craft Pizza & Pub franchisees. As you know, our Lafayette franchisees has signed an agreement for a location in West Lafayette, the home of Purdue University.

We already have a few prospective sites to analyze, but it may take a while to finalize on a specific site. Real estate market there is very tight and we want to make sure we have a great site to capture the full potential of the market.

Our Evansville franchisees finalized the site on the west side of Evansville near the University of Southern Indiana, and it's already submitted for construction permits. We currently anticipate in late October opening for that location for such things on contract selection process and any delays that might happen that's our current expectation.

And one last development I'll bring up before we turn to the questions is the introduction of our first pizza dare night. Next Friday night, not this Friday, but next Friday, we'll have our R&D assistant dressed up as Executive Chef Tyler and he'll be roaming our picturesque location with free tastes of a new pizza we call octopi. And this is a pizza that features baked octopus along with roasted red bell pepper, mozzarella and cheddar cheese, garlic bagel, red sauce and a rosemary infused olive oil. It actually taste fantastic.

We're going to be promoting this event through social media and press releases beginning Monday. The idea is to invite people in for a regular dinner that Friday and then dare them to give this really unique and bizarre pizza to taste. We hope that leads to a lot of Monday morning talk at work and a lot of fun. In fact, we have a whole series of these dare nights plan and we'll be featuring alligator, python, rattlesnake, cactus and jellyfish. So if any of you want to take the dare and try octopus pizza, come to our picturesque store next Friday and give it a try. We'll be sampling it between 5:30 PM and 7:30 PM.

Okay, so about to wrap up the presentation portion of the call. Next, Paul and I'll be taking questions. [Operator Instructions]

Question-and-Answer Session

A - Scott Mobley

Go ahead. Larry, are you on the line?

Unidentified Analyst

Yes. Hi. I'm sorry. I didn't know I was accepted. Basically, two questions involving the same situation. On the consolidated balance sheet for 2019 under long-term obligations you have a line for convertible notes payable 1,529,270 million. I believe those notes are due in two months.

Scott Mobley

Part of them aren't.

Unidentified Analyst

What said?

Scott Mobley

Part of them are not. It's 2023.

Unidentified Analyst

No. Those notes are due in 2019.

Scott Mobley

Some of them are. Some of them have been extended.

Unidentified Analyst

That's true. But the ones that have not been extended are not long term liabilities. They're certainly short term liabilities. And my question was…

Scott Mobley

Their long term liabilities served because our senior loan agreement prohibits those from being paid. So they can be converted or they can be refinanced, but they can't be paid out of current assets, so their long term liability.

Unidentified Analyst

I'm not sure, I understand that.

Scott Mobley

Well I'd be glad to discuss it with you further, if you want to give me your phone number, I'll give you a call off line. But I don’t want to take your more time right now.

Unidentified Analyst

Sure. My other question was what is the ability of the company to pay them if assuming they are payable in November?

Scott Mobley

They are not payable in November, sir. I just thought, they’re saying that.

Unidentified Analyst

Okay, okay. If you can give me a call at your convenience. You want the number or you own it already -- I can leave it.

Scott Mobley

We have the number.

Unidentified Analyst

Okay and thank you very much for your time and attention.

Scott Mobley

All right. Thank you.

Unidentified Analyst

Hi. This is Mark. Congrats on a very good quarter. Where do you see the Craft and Pub margin down at 16% or what 15.7% this quarter? Do you see that similar going forward?

Scott Mobley

No. We will certainly work to get those back up. There is some -- our variable cost are very well controlled and actually are lower than they were in previous quarters. So we had some fixed costs like primary charges and some insurance costs, some additional delivery charges because switching to the -- but we've got to work to chip away at those fixed costs and get them back down to where we can get our margins back up in the range of where they were.

And the other way to do that obviously is to which we're working on broadening our demographic appeal and advertising, so we can increase our sales further. Although we have very profitable good sales, we felt, we still know there's room for improvement and that's why we're working on broadening our demographics to make that happen.

Unidentified Analyst

Yeah, it looks like the sales are really solid for the quarter. Do you see that trend continuing through -- did you see that in July and so far through August, kind of similar on that. I think it was pretty close to what -- like 425 a month or so I believe?

Scott Mobley

Those averages vary up and down depending on how the month falls. But yes, I would -- yes I see that continuing on to the fall. In reality, we hope to see some increase to that.

Unidentified Analyst

Okay. Great. Thanks.

Scott Mobley

Thank you.

Unidentified Analyst

Hey, guys. This is Nick Katz [ph]. Congrats on a great quarter. Just one question is, why was cash flow -- looking at operating cash flow below net income again? And do you see those numbers converging going forward on a consistent basis? Thank you.

Scott Mobley

They have been converging someone not going to know, but they're not quite there yet, but I think we're approaching that and hopefully keep saying this the next quarter or the next will be for those equal. All right. Thanks Nick.

Unidentified Analyst

Hi. This is Bill Redpath [ph]. A couple of questions. First of all, I believe it was mentioned five new, if you get this financing, five new company-owned Craft Pizza & Pubs you would be looking at, where would -- where do you think those would go. Correct me if I'm wrong, you have four right now. None of them are in Marion County. You haven't touched that yet. And where do you think they would go. That's one question.

Second question has to do with CP&P franchisees. Right now you've got one store open in Lafayette. You've got one under construction in Evansville. There you're looking for a location or the franchisee and you were looking for a location in West Lafayette. Just wondering how far and wide are -- have you received interest from potential out-of-state franchisees, out of Indiana. And if so when do you think you might start franchising outside the state of Indiana.

Paul Mobley

Locations?

Scott Mobley

Sure. Well, I'll tackle your first question here. And that's the potential location of new company units. So currently those people that are not familiar with geography of Central Indiana pretty much have Marin County in Indianapolis in the center of the state. And our current locations sort of span the breadth of the north side of the greater metropolitan area.

So there are additional similar types of communities located to the west of Indianapolis that would include cities such as Brownsburg and Plainfield.

We have a prospective site that we can tie up in Brownsburg. And then moving south, on the south side you have communities such as Greenwood and potentially Franklin. And then moving east we have Greenfield and then further south you also have very strong markets in Bloomington and Columbus. And there are other locations that we might be able to identify in and around Indianapolis as well such as in gates areas, which is on the northeast side. There might be potential also for downtown Indianapolis which is familiar with Indianapolis a very thriving part of the town.

And so there's absolutely no shortage of locations that would fall within our existing supervisory structure, so that we can leverage our existing personnel and supervision costs of those three units. And Paul, do you want to….

Paul Mobley

Okay. Of course, franchising outside of Indianapolis, yes, we would consider going outside of Indiana, only if we have a franchisee substantial stature, a existing operational team, existing markets they control with some other concept, but not with a new franchisees. We would not consider outside of Indiana at this point.

We're trying to build a base that we want to have -- be strong. Yes, we can go outside and we can find all kinds of locations. I've talked to many prospects there and most of them down, because we're more interested in building that quality base than we are taking on few additional locations at the moment, because we don't want people who cannot operate, don't have the experience to operate, don't have the financial resources to operate. We want solid people to grow the base, so we can keep expanding out from our centre.

Unidentified Analyst

All right. Thanks Scott.

Scott Mobley

Go ahead, Mark [ph]. Do you have another question?

Unidentified Analyst

Hi. Yeah. Just a quick one, I think you pretty much answered it on your -- from your last caller. I don't think is there -- would there be any plans to -- I think you said, I thought you said something about perspective sites in Brownsburg, is anything in the works as far as hoping that to be open by 2019.

Scott Mobley

Yes, we would plan on opening before the end of 2019. I would hope that we could open it October, but we don't know for sure yet.

Unidentified Analyst

Okay. Thank you.

Scott Mobley

That be a general ballpark.

Paul Mobley

All right. Thanks Mark.

Paul Mobley

Okay. We don't currently show any other phone numbers or names with questions. If you check-in and have a question, well hang on the line here for a few minutes and see if we have any additional.

Okay. I don't see any additional questions. So with that, we'll go ahead and bring this conference call to the close. Once again we appreciate your participation. I hope you all have a good evening. We'll be terminating the session connection now. We'll be back next quarter. Thank you.

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