

Seeking Alpha^α

Transcripts

Noodles & Company (NDLS) Q3 2024 Earnings Call Transcript

Nov. 07, 2024 1:00 AM ET | Noodles & Company (NDLS) Stock

**SA Transcripts**

150.22K Followers

Q3: 2024-11-06 Earnings Summary

Play Call



Press Release



10-Q

EPS of -\$0.12 **misses by \$0.06** | Revenue of \$122.75M (-3.99% Y/Y) **misses by \$3.10M**Noodles & Company. (NASDAQ:[NDLS](#)) Q3 2024 Earnings Conference Call November 6, 2024 4:30 PM ET

Company Participants

Drew Madsen - Chief Executive Officer

Mike Hynes - Chief Financial Officer

Conference Call Participants

Jake Bartlett - Truist Securities

Operator

Good afternoon, and welcome to today's Noodles & Company's Third Quarter 2024 Earnings Conference Call. [Operator Instructions]. As a reminder, this call is being recorded. I would now like to introduce Noodles & Company's Chief Financial Officer, Mike Hynes. Please go ahead.

Mike Hynes

Thank you, and good afternoon, everyone. Welcome to our third quarter 2024 earnings call. Here with me this afternoon is Drew Madsen, our Chief Executive Officer. I'd like to start by going over a few regulatory matters.

During the call, we may make forward-looking statements regarding future events or the future financial performance of the company. Any such items should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Such statements are only projections, and actual events or results could differ from those projections due to a number of risks and uncertainties, including those referred to in this afternoon's news release and the cautionary statement in the company's quarterly report on Form 10-Q and subsequent filings with the SEC.

During the call, we will discuss non-GAAP measures, which we believe can be useful in evaluating the company's operating performance. These measures should not be considered in isolation or as a substitute for our financial results prepared in accordance with GAAP. A reconciliation of these measures to the most directly comparable GAAP measures is available in our third quarter 2024 earnings release.

To the extent that the company provides guidance, it does so only on a non-GAAP basis and does not provide reconciliations of forward-looking non-GAAP measures. Quantitative reconciling information for these measures is unavailable without unreasonable efforts.

With that, I would like to turn the call over to Drew Madsen, our Chief Executive Officer.

Drew Madsen

Thanks, Mike, and good afternoon, everyone. Our third quarter results reflect both industry-wide volatility caused by a difficult consumer environment that has led to significantly elevated levels of competitive discounting as well as two other dynamics specifically related to Noodles, a high level of prior year discounting in the third quarter plus an unexpected sudden drop in third-party delivery sales. Collectively, these negatively impacted our short-term results in the third quarter.

That said, we remain very encouraged by our positioning for long-term growth, aided by the positive early results from our menu innovation work, which I will touch on shortly.

Let's start with the third quarter dynamics. First, last year, Noodles pursued an aggressive discounting strategy to help offset the impact of the February price increase. This year, we've chosen to prioritize guest experience improvements driven by operations excellence, normalize our discount level and invest the savings in targeted loyalty program outreach, broader digital media messaging and increased third-party marketplace spending to drive longer-term sustainable improvements. This strategy was effective in helping us improve month by month from a significant gap in sales and traffic versus the fast casual industry benchmark in January to equaling the benchmark in July.

However, a significant increase in competitive promotions and discounting this year, combined with our own elevated levels of discounting last year proved challenging in August and September for our same-store sales. As a result, later in the third quarter, we moved to temporarily increase our level of promotional support to compete more effectively in the near term while our menu transformation progresses. This included the addition of a kids eat free offer in mid-September and a buy one get one offer in connection with the rollout of three new menu items in October. And we have seen a significant improvement in sales to date in the fourth quarter, even as the buy one get one promotion has ended.

As I noted earlier, we saw a sudden and significant decline in third-party delivery sales with our biggest partner starting late in July. We've also worked with this third-party delivery partner to identify and test a strategy to address the sales decline we have experienced in this channel and believe we've identified a solution which should help these sales recover.

As I just noted, in early October, we were excited to roll out three of our new menu dishes nationally and are very encouraged by the noticeable improvement we saw in our traffic trends relative to the third quarter as a result. This has given us increased confidence in our strategic vision and the menu innovation improvements still to come.

Although the current consumer environment has caused variability in our near-term results, we're focused on what we can most directly impact and continuing to position Noodles to capture the significant growth opportunity we believe it has long-term.

Importantly, we continue to make meaningful progress on all five of our strategic priorities to achieve sustained profitable growth and drive long-term shareholder value. We also continue to strengthen our senior management team.

Last week, we announced the appointment of Stephen Kennedy as our new Executive Vice President of Marketing. Stephen brings considerable expertise in digital innovation, paid digital media, loyalty and brand building. He will be a very strong partner with Scott Davis, our new Chief Concept Officer.

Now let's talk about our progress on each of our five strategic priorities. Creating a foundation of operations excellence remains our top priority. Building this foundation demands that we be brilliant with the basics of staffing, training and consistently executing to standards that will make us a better competitive alternative. Importantly, we've made great strides in all three areas.

On staffing, our turnover at both the hourly and management levels continue to improve. In fact, our management turnover is now well below industry average. On training, we continue with biweekly sessions across the system to review proper execution of a new food execution standard, a new service standard and a new accuracy standard during each training session. Our primary training focus is to improve the dimensions of our guest experience that correlate most directly with traffic growth, overall satisfaction, taste of food and accuracy.

Finally, on execution, the combination of team members who are better trained and managers who are in our restaurants more consistently during our busiest periods to provide immediate coaching has led to guest satisfaction scores accelerating each month of the quarter on all 3 of our priority measures.

For perspective, a one percentage point improvement in our guest satisfaction surveys is statistically significant. And our overall satisfaction has improved by 10 percentage points in the last six months. As a result, our gap between the fast casual industry average on overall guest satisfaction has already been reduced by more than half with all of this progress coming before our new menu transformation.

In the near term, it's difficult to correlate guest satisfaction improvement with traffic growth, but we are clearly establishing the culture and team member behaviors for a more consistent and a more satisfying guest experience. And I'm confident this will drive stronger guest loyalty and improved traffic over the long-term.

Our second priority is to stimulate more guest desire for noodles through a comprehensive menu transformation guided by our contemporary Comfort Kitchen culinary North Star. Phase 1 of this process involved concept testing to identify the most compelling ideas for both new and improved dishes.

During Phase 2, we placed the new and improved dishes created by the culinary Edge in a central location taste test with noodles customers to ensure they exceeded the guest satisfaction average on our current menu. These first 2 phases are complete.

Phase 3 began in July when we placed the best new and improved dishes in test locations to assess real-world guest satisfaction, operational feasibility and any related financial implications, including menu mix shifts. Our goal is to impact roughly 2/3 of our menu through new or improved offerings over the next year, given the magnitude of change involved for both guests and operations, we are taking a very thoughtful and strategic approach to testing, and we plan to stagger the national introduction of the complete updated menu over several months. And I'm excited to say that the national introduction has begun.

In October, we introduced three of these new dishes nationally. Crispy Chicken Bacon Alfredo is a more contemporary version of our current Alfredo MontAmore, which it replaced. In just a few weeks, it has become the most viewed item on our digital menu and our second best-selling dish overall, with average daily unit sales more than double Alfredo MontAmore.

The second dish introduced nationally, Lemon Garlic Shrimp Scampi addresses the need we identified for additional light and fresh menu options.

The third dish, Chipotle Chicken Cavatappi was added to address the need we identified for a Latin-inspired flavor profile on our menu. Both dishes address gaps in our current menu offering, have guest satisfaction equal to or better than our current menu average and are meeting our sales expectations based on prior test market results.

The introduction of these three dishes was supported with a new commercial shot inside a noodles restaurant called "Taste the Start of Something Great", showcasing all three dishes and emphasizing our commitment to bold, exciting culinary innovations. To encourage trial, as I mentioned earlier, we also offered a buy one get one free exclusive offer to our rewards members as a special perk for being a part of the program.

And our guests are beginning to notice. Traffic has improved from a run rate of approximately minus 6% before these changes were introduced to just minus 0.8% fourth quarter to date, not yet where we want to be even in a challenging environment, but most importantly, shows that our menu innovation work has the ability to positively impact our traffic trends.

To help maintain this momentum, advertising during November and December will continue to focus on these three new dishes, supported by an increased level of media investment compared to last year.

Looking ahead to further menu innovation, in two weeks, we will introduce three new signature Mac & Cheese dishes into our test restaurants. Garlic Bacon Mac Crunch, Pull Pork Barbecue Mac and Buffalo Chicken Ranch Mac. These three dishes have been our strongest performers in central location taste test so far and when combined with an improved Wisconsin Mac & Cheese should account for our largest sales mix category. So we believe improvements, enhancements and newly introduced Mac dishes should have a very positive impact on our traffic when introduced nationally. Assuming the success of these new dishes in our test markets, they will be introduced nationally during the first quarter of 2025.

Our third priority is to drive profitable traffic growth by further leveraging our strong digital ecosystem. As a reminder, Noodles has 55% of total sales from digital channels. Additionally, our loyalty members account for 26% of total sales and spend twice as much per year as non-loyalty members.

Last year, we invested in a customer data platform that aggregates all information about our known customers in one area. This has enabled us to engage these customers using smart, relevant personalized offers with fewer discounts to drive profitable traffic growth. In particular, we focus on reactivating lapsed loyalty members because our active members have frequency more than 50% higher and have 2.5 more visits per year than our loyalty program average.

To double down on one of our core equities is a family-oriented brand, in September, we introduced a Kids Eat Free promotion, which drove approximately 1.5% in incremental sales. This allowed us to showcase our menu improvements and reintroduce customers to the constantly improving Noodles experience.

During Q4 this year, we will launch our new app for Android and iOS with an all-new home screen and rewards store experience. This update is intended to further strengthen our conversion rate once guests start an order by introducing easy-to-use quick actions like reorder, order a favorite and order a saved order, while also allowing loyalty members to attach their most relevant active loyalty program reward.

Turning to delivery. Our third-party delivery channel was a strong traffic-driving channel for us through the first half of this year. Starting early in the third quarter, traffic from our largest partner suddenly began to decline despite continued investment in sponsored listings, exclusive dishes and profitable promotions. This change in trend was a significant contributor to our negative comp results for the quarter.

Discussions with this partner identified a potential opportunity to increase traffic profitably by addressing our menu markup on their platform. We are roughly one month into a test of different menu markups with encouraging results. We plan to finalize the test and introduce the optimal menu pricing strategy next month, which we believe will meaningfully improve traffic in our third-party channel.

Our fourth priority is to maintain double-digit growth in our catering business while we improve the fundamentals required to drive more aggressive growth in the future. Catering has grown from 1% of sales in 2022 and 1.2% in 2023 to 1.7% year-to-date in 2024.

During the third quarter, system-wide sales were up 27% versus last year. We continue to believe catering has the potential to be at least 4% to 5% of sales in the future. And we believe that catering growth would be incremental and contribute to higher overall margins.

During the quarter, we had multiple wins in our catering channel, including unlocking a new catering occasion in back-to-school during August, which generated our third highest catering sales week to date this year, driving repeat purchase and attracting new users with dedicated food news messaging about our three new menu items on our catering landing page and generating impressive sales from our new fractional catering managers who drive incremental sales by creating strong relationships with schools and local sports teams in high potential markets. We will also strengthen our catering operating model by reducing operator friction and increasing throughput in our restaurants.

During the third quarter, we rolled out a new ezCater integration capability in all company restaurants, eliminating the need to manually rekey orders from the ezCater third-party catering platform into our point of sale. In addition, we are currently evaluating options to outsource delivery of catering orders placed through our website and a technology-driven solution to transfer catering orders between restaurants when needed.

Our final priority is to strengthen our financial foundation with proactive cash management and an increased emphasis on operational efficiency across the business. This year, we have reduced our capital spending from \$52 million in 2023 to a projected \$29 million to \$31 million in 2024, implemented a major cost reduction effort, we expect to deliver over \$5 million of savings in 2024, performed a detailed portfolio review that identified approximately 20 restaurants that we're evaluating for closure before the end of their lease terms. Mike will discuss in more detail where we are in the portfolio review process.

And we announced last week an amendment to our revolving credit facility, which reflects the strong support we have from our bank group, while we are in the process of executing on our strategic pillars.

Despite the third quarter decline in sales, our liquidity position remains solid. In addition, our reduced level of capital expenditures puts us in a better position to reach our target of positive free cash flow in 2025.

As you can see, we've made substantial progress on all of our strategic priorities and believe we are positioning Noodles to capture the full growth opportunity we see ahead.

Now I'll turn it over to Mike to review our financial results in more detail.

Mike Hynes

Thank you, Drew. In the third quarter, our total revenue decreased 4.0% compared to last year to \$122.8 million. System-wide comp restaurant sales during the third quarter decreased 3.3%, including a decrease of 3.4% at company-owned restaurants and a decrease of 2.9% at franchise restaurants. Company comp traffic during the third quarter declined 5.8%, pricing contributed 2.2% and mix contributed 0.2%.

The 4th of July shift from the second quarter in 2023 to the third quarter in 2024 negatively impacted our third quarter comp sales by approximately 80 basis points. Company average unit volumes in the third quarter were \$1.27 million. Restaurant level contribution margin was 12.8%, down from 16.4% in the third quarter of 2023, primarily due to sales deleverage.

COGS in the third quarter was 25.5% of sales, a 40 basis point increase from last year. Our third quarter pricing benefit was offset by inflation and mix shift.

Labor costs for the third quarter were 32.0% of sales, which was up 70 basis points to prior year, primarily driven by sales deleverage. Hourly wage inflation was 2.4% versus prior year, which was largely offset by pricing.

Occupancy costs were flat versus prior year at \$11.5 million and other restaurant operating costs increased 210 basis points in the third quarter to 20.1%. The increase in other restaurant operating costs was primarily driven by a combination of sales deleverage and increases in marketing expenses and third-party delivery fees.

G&A for the third quarter was \$12.9 million compared to \$11.9 million in 2023, primarily due to expenses from the company's 2024 Summit, which is a biannual national conference with our managers, vendors and franchise partners. We also had an increase in obsolete warehouse inventory expenses related to menu transformation.

Net loss for the third quarter was \$6.8 million or a loss of \$0.15 per diluted share compared to net income of \$700,000 or earnings of \$0.02 per diluted share last year. Adjusted EBITDA for the third quarter was \$4.9 million compared to \$10.9 million in the third quarter of 2023.

In the third quarter, we opened three new company-owned restaurants and closed five company-owned restaurants. One franchise restaurant was opened and one franchise restaurant was closed in the third quarter. One additional new franchise restaurant opened in October to bring the year-to-date franchise openings to three. Also in October, four company-owned and three franchise restaurants were closed.

As we discussed last quarter, we're undertaking a comprehensive portfolio review where we're evaluating closing underperforming restaurants on or before their lease expiration dates. Our accelerated rate of closures in the back half of this year is a result of that process. We continue to negotiate with landlords, and we will determine future potential closures on a case-by-case basis.

Turning to full year 2024 guidance. We have revised certain expectations for the full year to reflect our recent trends and the continued challenging consumer environment. For the full year 2024, we are providing guidance of \$487 million to \$495 million for revenue, inclusive of negative 3% to negative 1.5% comp restaurant sales. We anticipate full year restaurant contribution margin between 12.7% and 13.3%.

General and administrative expenses of \$51 million to \$53 million, inclusive of stock-based compensation expense of approximately \$4.5 million, depreciation and amortization expense of \$28 million to \$30 million and interest expense of \$8 million to \$9.

In October, we completed our 2024 new restaurant development. For the full year, we opened a total of 10 new company-owned restaurants and three new franchise restaurants. We expect total 2024 capital expenditures between \$29 million and \$31 million. We currently expect to close a total of 12 to 14 company-owned restaurants and seven franchise restaurants in fiscal year 2024.

In fiscal year 2025, we anticipate having substantially lower capital expenditures, primarily due to a reduction in company-owned new restaurant openings from 10 in 2024 to two planned openings in 2025. As a result, our expectation is that 2025 total capital expenditures will be less than \$15 million.

At quarter end, we had a total debt balance of \$89.9 million and over \$30 million of incremental liquidity available for future borrowings under our credit facility. As Drew mentioned, last week, we amended our credit agreement to provide for more flexible financial covenants, which together with our cash savings efforts and lower capital expenditure run rate will improve our overall financial flexibility.

With that, I'll turn the call back over to Drew for final remarks.

Drew Madsen

Thanks, Mike. I am excited about our continued progress on our five key priorities. Our foundation of operations excellence is improving, and our many transformation is on track with encouraging early test market results and an initial national rollout of three of our new dishes. I look forward to sharing more progress with you soon. Thank you for your time today.

Operator, please open the lines for Q&A.

Question-And-Answer Session

Operator

[Operator Instructions]. Our first question comes from Jake Bartlett from Truist Securities. Please go ahead.

Jake Bartlett

Great. Thank you so much for taking the question. My first one was about the trajectory of sales throughout the quarter. It looks like roughly consistent in August and September versus where you started in July. And we've heard from others that there was an acceleration in trends that July was largely the bottom. A couple of moving pieces you mentioned. I just wanted to just make sure maybe try to disaggregate some of the impacts at the end of July, the drop-off in delivery sales. You also mentioned you increased promotional activity. Just trying to reconcile your trends, what drove it versus what looks to be like an accelerating trend throughout the industry?

Drew Madsen

Yes. Thank you, Jake. I'll start on that. And you're right, at the end of July is when we saw a sudden drop in our third-party delivery channel sales, and that's a significant channel for us with a material drop. And I think that's the biggest reason that we didn't mirror the rest of the industry in August.

In addition, we were wrapping on more aggressive promotional support of our own in the prior year that we had chosen not to pursue this year because up until August, our strategy to position Noodles for long-term sustainable growth was working. So that's exactly why we pivoted to a different promotional strategy when we introduced our new dishes.

And as we said, Q4 sales and traffic trends since then have improved materially with these new dishes, some increased advertising support and those positive trends have continued more than two weeks after our [Indiscernible] has expired.

In addition, our test market results remain strong with more food news to come, starting with the three new Mac & Cheese dishes that I mentioned. Our foundation of operations excellence and guest satisfaction continues to improve. We believe we've identified a new strategy to regain profitable traffic growth in the third-party delivery channel. We'll be activating that shortly. And so while the challenging consumer environment impacted our Q3 results, we feel very good about capturing the opportunity ahead.

Jake Bartlett

Great. And maybe just to go in a little more detail as to what happened in delivery and the sudden drop off. You mentioned identifying the reason. It doesn't sound like you would change anything. It sounds like maybe -- was the reason that just the platforms just got more promotional highlighted value in general? I'm just trying to understand what would have caused the deceleration and the kind of the identification that I think it sounds like you need to lower your prices within the delivery channel.

Drew Madsen

Yes. We didn't change our strategy or our investment or our approach to engaging on the third-party channel. We believe that our existing menu markup was what caused the problem, and we're evaluating alternative menu markups to make ourselves more compelling to the algorithm on that platform.

Jake Bartlett

Okay. So you -- so was the consumer behavior change or just the algorithm just drove consumers in a different direction given where your pricing was? I'm just trying to understand the trajectory change, what -- anything specific happened -- or did the consumer change?

Drew Madsen

The consumer didn't change. We believe it was the latter. The algorithm changed.

Jake Bartlett

Okay. Great. And then just in terms of your guidance, I understand the wide range, it's an uncertain environment. It looks like at the high end is slightly less -- I'm looking at the fourth quarter comp guidance, implied comp guidance of roughly 1% to negative 5%. So obviously, a pretty wide range. It sounds like with pricing, I just want to make sure I'm right that you would be at that -- roughly at that 1% already if you're looking at traffic of negative 0.8%. Is that right? And I guess I'm just trying to understand the -- why such a wide range? And do you feel fairly confident that current trends can at least continue?

Mike Hynes

So first on the pricing, effective pricing in Q4 will be just over 1%, about 1.3%. And so together with the traffic trend we talked about, it gives you a base of just under 1% today when you look at quarter-to-date results impacted by [Indiscernible] and our kids free promotion, which drive our check a little lower.

The guidance range, we wanted to leave room for variability, which we've seen all year. So we wanted to make sure we captured some upside, which we believe in, and we believe we have room to the upside as third-party delivery continues to improve week-over-week in Q4 and as we build on the momentum with our three new dishes. But we also wanted to recognize there has been variability and leave some room for that on the downside.

Jake Bartlett

Great. I have one more, then I'll pass it on. And that is just around your free cash flow generation. You mentioned, Drew, that you thought you'd be positive in 2025. I'm wondering whether that's a commentary that you'd be positive for 2025 as a whole or at just some point during 2025, you would turn positive from a free cash flow perspective?

Drew Madsen

Yes. Our expectation is that with lower CapEx, much lower CapEx under \$15 million expected for 2025, and that -- it's a pretty broad guidance point there. We haven't totally fine-tuned 2025 CapEx, but we know with just two planned openings, it's going to be sub-\$15 million that we're going to have an opportunity for the full year to be free cash flow positive and then be able to carry that forward.

Jake Bartlett

Great. Thank you so much. I'll pass it on.

Drew Madsen

Thank you, Jake.

Operator

Thank you. I'm showing no further questions. Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

Read more current NDLS [analysis and news](#)

View all [earnings call transcripts](#)

Comments

Newest

