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Shake Shack Inc. (SHAK) Q3 2024 Earnings Call Transcript

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10-Q

EPS of \$0.25 **beats by \$0.06** | Revenue of \$316.92M (14.74% Y/Y) **beats by \$787.89K**Shake Shack Inc. (NYSE:[SHAK](#)) Q3 2024 Earnings Conference Call October 30, 2024 8:00 AM ET

Company Participants

Michael Oriolo - Vice President, FP&A & Investor Relations

Rob Lynch - Chief Executive Officer

Katie Fogertey - Chief Financial Officer

Conference Call Participants

Michael Tamas - Oppenheimer & Company

Brian Vaccaro - Raymond James

Lauren Silberman - Deutsche Bank

Christine Cho - Goldman Sachs

Brian Mullan - Piper Sandler

Andrew Charles - TD Cowen

Brian Harbour – Morgan Stanley

Sharon Zackfia - William Blair

Peter Saleh - BTIG

Jake Bartlett - Truist Securities

Sara Senatore - Bank of America

David Tarantino - Baird

Andy Barish - Jefferies

Jim Sanderson - Northcoast Research

Daniel Guglielmo - Capital One Securities

Jeffrey Bernstein - Barclays

Rahul Krotthapalli - JPMorgan

Operator

Greetings. Welcome to Shake Shack's Third Quarter 2024 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to hand the conference over to Michael Oriolo, Vice President of FP&A and Investor Relations.

Thank you. You may begin.

Michael Oriolo

Thank you, and good morning, everyone. Joining me for Shake Shack's conference call is our CEO, Rob Lynch; and CFO, Katie Fogertey. During today's call, we will discuss 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 to comparable GAAP measures are available in our earnings release and the financial details section of our shareholder letter.

Some of today's statements may be forward-looking, and actual results may differ materially due to a number of risks and uncertainties, including those discussed in our annual report on Form 10-K filed on February 29, 2024. Any forward-looking statements represent our views only as of today, and we assume no obligation to update any forward-looking statements if our views change. By now, you should have access to our third quarter 2024 shareholder letter, which can be found at investor.shakeshack.com in the quarterly results section where as exhibit to our 8-K for the quarter.

I will now turn the call over to Rob.

Rob Lynch

Thank you, Mike, and good morning, everyone. It's been a great third quarter. We delivered our 15th consecutive positive quarter of Same-Shack sales growth, our ninth straight quarter of restaurant level margin expansion, and we grew adjusted EBITDA 28% to \$45.8 million.

We grew our footprint around the world to over 550 Shacks opening a total of 17 new Shacks during the quarter comprised of 8 domestic company-operated openings, including 3 new drive-thrus and 9 new licensed Shacks. We are on a path to open approximately 75 Shacks system-wide this year, representing mid-teens unit growth.

Our new company units are tracking strong cash-on-cash returns as we continue to bring down build costs and pre-opening costs per Shack. The team continues to find ways to deliver efficiencies, and we are on target for an approximate 10% cost reduction in 2024 build costs.

Our new Shacks are also outperforming initial sales expectations and company restaurant level profit margins continue to expand. We expect to deliver further improvements across these metrics in 2025 and as a result, we'll accelerate our new unit openings to approximately 80 to 85 next year, including 45 company-operated Shacks and 35 to 40 licensed Shacks.

Sales on our existing Shacks were also strong in the third quarter as we delivered 4.4% Same-Shack sales growth with positive traffic. A direct result of our sales-driving strategies and our consistent differentiated premium positioning, which has allowed us to continue to outperform even in an uncertain macro environment.

A big part of our success in the third quarter and an even bigger part of our future is Shake Shack's continuous culinary innovation. Memorial Day weekend, we launched our summer barbecue menu, which featured two burger options, each with either a smoky or tangy soft, along with barbecue spice fries. Then in mid-September, we brought back our guests favorite the Black Truffle Burger, including Shroom and Shack Stack options, as well as the Parmesan Garlic Fries with Black Truffle Sauce.

The Black Truffle LTO is a perfect example of Shake Shack's elevated culinary program and our ability to offer differentiated culinary experiences at great value which particularly stand out in today's value wars environment.

In addition to culinary innovation, we continue to strike the right balance with strategic promotions and marketing campaigns stays awareness and drive conversion. In September, by popular demand, we brought back Chicken Sundays, which we originally ran for four weeks in the second quarter. Chicken Sundays have been solid sales contributor in the short-term, but even more importantly, we have seen promising results in our overall chicken awareness, which we expect to drive chicken sales at Shake Shack long after the promotion ends.

We also ran other value-added campaigns to spotlight menu highlights such as Free Shake Friday and our dog days of summer. Our marketing continues to attract new and repeat guests, and we will continue to make these strategic investments moving forward.

And as I look ahead, I am encouraged by the fact that we still have multiple sales driving platforms and initiatives to build on and implement. Among the significant number of sales-driving initiatives in our pipeline, three stand out. The first is the development of a strategic product innovation calendar. The second is the development and launch of a Shake Shack loyalty platform. And last, but certainly not least, is the additional operational enhancements that will increase guest satisfaction, decrease service times and improve throughput.

I'll touch here briefly on each. As we work to build and highlight the upside potential of a strategic product innovation calendar, it's not lost on me that culinary innovation is already a part of Shake Shack's DNA. However, we have an opportunity to become more strategic and ensure that new innovation works in a complementary way with our core menu to drive outpaced comp growth. We are actively working to build this capability in the first half of 2025 and to leverage the benefits moving forward.

As you know, beyond the hospitality and guest recognition, our team members exclude each day, Shake Shack does not currently have a systematized loyalty program. I can't help but find that a bit ironic given that Shake Shack was built on the principles and culture of enlightened hospitality where understanding the wants and needs of our guests is paramount.

I truly believe that given this heritage, we have an outsized opportunity to deliver enlightened hospitality in a world that increasingly craves it, but across a digital footprint. We will be making investments in 2025 to develop the right platform to realize this potential over the long-term.

Lastly, on operational optimization that drive sales. In the third quarter, we further decreased lead times and improved guest satisfaction metrics and as a result, drove higher sales and margins. However, we still have a lot of opportunity for improvement, both short and long-term. In the short-term, we are working on the blocking and tackling of operational excellence, including speed of service initiatives, process improvements and world-class training of our people.

Over the longer term, we're working to optimize our kitchen flows, equipment packages and guest service models. All of these initiatives are expected to be long-term builders of repeat visits, which will increase frequency and overall sales. Speaking of great operations, we're driving a significant margin improvement even as we make additional investments in marketing and promotions to grow top line sales.

Third quarter restaurant level margins expanded 60 basis points and adjusted EBITDA margins grew 140 basis points. And we expect fourth quarter to end on a high note as well with fourth quarter restaurant level margins expanding 220 basis points and exceeding 2019 levels for the first time.

The team is doing a great job at utilizing our increasing scale to find supply chain efficiencies, improving labor utilization across both staffing and scheduling and being more disciplined among other costs.

All-in, the third quarter was another successful quarter of sales, restaurant-level margin, and adjusted EBITDA growth, which we expect to continue into the fourth quarter. Looking ahead, we expect this momentum to extend into 2025 as we accelerate unit growth.

With that, I'll turn the call over to Katie for a more detailed discussion on third quarter financial results and our outlook for the rest of the year.

Katie Fogertey

Thank you, Rob and good morning. We are really proud of Shake Shack's strong third quarter results as we grew total revenue by 14.7% versus last year, expanded restaurant-level profit margins by 60 basis points, and grew adjusted EBITDA by 28% to 14.4% of total revenue, up 140 basis points.

This continues our trend that for each quarter, over the past three years, we have generated positive Same-Shack sales and grown total revenue, restaurant-level profit, and adjusted EBITDA by double-digits.

This quarter, we also achieved record high total revenue in system-wide sales as well as the highest third quarter restaurant and adjusted EBITDA margin since 2019. And I'll share more in a little bit but our guidance for the next quarter on restaurant and adjusted EBITDA margins well exceeds our fourth quarter 2019 performance as we continue to execute against our strategic priorities.

Now, for the details of our third quarter results. We grew total revenue by 14.7% year-over-year to \$316.9 million and system-wide sales by 12.8% to \$495.1 million. We opened 17 Shacks system-wide in the quarter and achieved the 15th consecutive quarter of positive Same-Shack sales.

In our license business, we grew revenue by 7.1% year-over-year to \$12 million. Sales grew by 9.4% year-over-year to \$190.2 million with nine new licensed Shack openings and strong trends in our domestic business that was led by airports and roadway travel classes.

In our domestic company-operated business, we grew Shack sales 15.1% year-over-year to \$304.9 million with eight Shack openings and 4.4% year-over-year growth in Same-Shack sales.

Traffic grew 30 basis points and Shack rose approximately 4%, with approximately 6% lending price. Mix was sequentially flat at negative low single-digits with the levels driven by planned marketing strategies. Items per Shack was slightly positive in the quarter.

Throughout the quarter, we remain focused on driving sales through our marketing initiatives in culinary innovation as well as operational improvements. These efforts have driven our outperformance, and we are encouraged by the trends that we saw across our regions.

In fact, we improved or maintained our strong Same-Shack sales trends in every region this quarter relative to last quarter, and grew Same-Shack sales by double digits in Florida, Arizona, Georgia, and Ohio, and by high single digits in markets such as Washington, D.C., Virginia, and Maryland.

We continued our strong sales performance into October with a positive 4.5% Same-Shack sales and approximately flat traffic for the month. We are excited about this continued momentum to start off the fourth quarter.

To help offset continued inflation, we implemented an approximate 1.5% price increase in October across our menu. This will allow us to maintain the approximately 6% menu price for the remainder of the year.

Heading into 2025, pricing will drop to approximately 4.5% in the first quarter and low single digits for the full year. In addition to driving sales, our focus on flow-through and operational improvement means that we are bringing this momentum to the bottom-line, and this was the ninth consecutive quarter of year-over-year restaurant margin expansion.

We generated \$64.2 million in restaurant level profit or \$0.21 of Shack sales, 60 basis points better than last year and the highest third quarter restaurant profit margins since 2019, despite continued inflationary pressures across our restaurant P&L. Our strategy of identifying and executing on operational efficiencies to reduce the total cost to serve has allowed us to grow profitably, while investing more in marketing strategies to drive sales and increase brand awareness.

Food and paper costs were \$86.1 million, or 28.2% of Shack sales, down 90 basis points versus last year, as menu price and strategic cost savings in our supply chain helped us offset continued inflationary pressures and our total cost to serve. Labor and related expenses were \$85.5 million, or 28% of Shack sales, down 80 basis points versus last year. Our teams did an excellent job transitioning to our improved hourly labor model late in the quarter and provided us with real-time feedback, which allowed us to show significant progress on hourly staffing, while at the same time, delivering improvements in operational and guest perception metrics, including having the lowest wait time since at least 2019.

And we're excited for what this new way of scheduling will allow for our guests and team members. And importantly, we have many additional strategies and test and underway to continue to optimize performance in our Shacks. Other operating expenses were \$45.6 million, or 14.9% of Shack sales, up 80 basis points year-over-year as we invested more in Shack-level marketing and other expenses to support our sales strategies.

Occupancy and related expenses were \$23.6 million, or 7.7% of Shack sales, in line with last year's levels. All in, we are very pleased with the level of margin improvement we delivered in the quarter and expect to build upon this momentum into the fourth quarter. G&A was \$35.7 million, excluding \$800,000 in onetime adjusted, G&A was \$34.9 million, or 11% of total revenue, 10 basis points lower than last year. The increase in G&A was driven by a significant increase in marketing spend to drive higher brand awareness and sales as well as executive transition.

The quarter also saw a benefit from a timing shift with some marketing spend that we initially planned for the third quarter now moving into the fourth quarter. Reopening costs were \$3.7 million in the quarter, down 26% year-over-year, and we continue to track well against our target to reduce pre-opening expenses per Shack by at least 10% this year. We grew adjusted EBITDA by about 28% year-over-year to \$45.8 million, or 14.4% of total revenue, up 140 basis points from the prior year and the best third quarter adjusted EBITDA margin since 2019.

Depreciation was \$25.7 million, up 11.2% year-over-year. In the quarter, we made a difficult decision to close nine Shacks to better focus our resources. These Shacks in total generated \$17 million in sales over the 12 months prior to their closure on August 27. While the financial performance of these Shacks was below our corporate average, they in total had a minimal negative impact on our restaurant-level profit.

We incurred \$28.2 million of expense related to these closures, including \$26.4 million impairment charge. Our managers at these locations were all offered a similar position in a nearby Shack. Including the charge, we realized a net loss attributable to Shake Shack, Inc. of \$10.2 million or a loss of \$0.26 per diluted share. We reported an adjusted pro forma net income of \$11.2 million, or \$0.25 per fully exchanged and diluted share.

Our GAAP tax rate was 25.9% and our adjusted pro forma tax rate, excluding the tax impact of equity-based compensation was 21.9%. And finally, our balance sheet remains solid, with \$310.9 million in cash and cash equivalents and marketable securities at the end of the quarter. This is up \$6.5 million versus the prior quarter. Year-to-date, with our focus on profitable growth strategies and lowering our build costs, we have increased our cash and cash equivalents and marketable securities balance by nearly \$18 million, marking a substantial improvement relative to a \$26 million decrease at this time last year and relative to the year prior to that, a \$45 million decrease.

Now we will discuss our outlook for the fourth quarter and fiscal year 2024, which reflects the financial impact from recent store closures, including the impact from the loss of revenue. Our fourth quarter guidance calls for total revenue of \$322.6 million to \$327 million, up 12.7% to 14.2% year-over-year, licensing revenue of \$11.6 million to \$12 million with approximately 11 license openings.

Same-Shack sales up approximately 3% to 4% with low single-digit price mix, approximately 16 company-operated openings, restaurant level profit margin of approximately 22%, as we expect to surpass 2019 quarterly margins for the first time. Our full year 2024 guidance calls for total revenue of approximately \$1.25 billion, growing about 15% year-over-year.

Same-Shack sales to grow about 3.3% to 3.6%, approximately 40 company-operated new Shack openings and approximately 35 license openings. We expect licensing revenue to reach \$44.6 million to \$45 million. Restaurant level profit margins of approximately 21%, representing approximately 110 basis points of expansion year-over-year, G&A guidance of \$144 million to \$145 million, that does not include the \$5.9 million in nonrecurring costs that are excluded from our adjusted EBITDA year-to-date. Equity-based compensation expense is approximately \$16 million, pre-opening of \$17 million, depreciation of \$103 million, adjusted pro forma tax rate, excluding the impact of equity-based compensation to be approximately 22.5%, adjusted EBITDA of \$168 million to \$170 million, representing approximately 27% to 29% growth year-over-year, nearly double our expected total revenue growth rate and representing a margin of approximately 13.5%, 140 basis points higher than the prior year and the highest adjusted EBITDA margin since 2019.

I want to end my remarks today sharing just how proud that we are and the work that the Shake Shack teams are doing to deliver these strong results, and also continuing to develop and test additional opportunities to enhance the guest experience, grow our business and improve our profitability.

And with that, I'll pass it back to Rob.

Rob Lynch

Thank you, Katie. It's a great time to be a part of Shake Shack. Thank you to everyone on the call today and for your interest in our company.

And with that, operator, please open up the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is from Michael Tamas with Oppenheimer & Company. Please proceed.

Michael Tamas

Hi, good morning. Thank you. You talked about investments going forward in the marketing and building out your loyalty program, just to name a couple. And I know you're not going to provide specific 2025 guidance yet. But can you impact for us, which of these initiatives you believe can have the greatest impact in the near-term into 2025 that could sort of allow you to sustain this flat to positive trend momentum that you have?

And then just directionally, how should we think about the margins related to that? Are you finding some additional cost to offset some of that stepped-up investment and then you're going to drive P&L leverage through the same-store sales? Thanks.

Rob Lynch

Thanks for the question, Michael. I'm really excited about the fact that we've been able to drive disproportionate top line sales growth, while continuing to increase our restaurant margins, that's the model moving forward. So our team has really built a surgical marketing engine that's allowing us to reach our most valuable customers and encouraging them to come back more often and to increase their basket size. And so even though, we have increased our marketing and our promotions, they're coming in. They're buying higher-margin items that we're featuring and adding to the Shack growth that we saw in the quarter.

In regards to next year and top line sales growth, we are currently investing and enhancing our guest recognition, which the outcome will be a loyalty platform. And I think I mentioned in the last call, that loyalty platform may or may not look like a traditional loyalty platform, it may be how Shake Shack does it. So but that probably is not going to have a significant impact in 2025. Those are technology investments that we're making during the course of the next year. So we are going to rely on the key drivers that we used in 2024 to deliver the 3% to 4% comps that we're guiding to.

Operator

Our next question is from Brian Vaccaro with Raymond James. Please proceed.

Brian Vaccaro

Hi, thanks. Good morning. You noted some strong improvements in a handful of states, I think in the South and Mid-Atlantic, maybe in the Midwest as well. And I guess I'm curious; could you elaborate on what you're seeing from an awareness standpoint, any quantification around that? Or any more color you can provide also on the traction that you're seeing on some of the digital value promotions? Any color on either of those would be helpful. Thank you.

Rob Lynch

Sure. We, obviously, are going to grow awareness for the brand just through our new Shack growth. We have seen great opening results to our Shacks so far this year, and that's really a testament to our ability and our marketing team's ability to generate excitement in the communities in which we're opening. And as you know and everyone knows, we have a ton of white space to go out and open more of these Shacks to deliver these great sales.

On the macro front, we did launch a brand campaign in New York City in Q3 and heading into Q4. And we have seen strong awareness results as an outcome of that. And we're looking to continue to do the analytics and understand those results better and their impact on driving sales in the markets where we invest. And ideally, we'll be able to scale those results nationally to continue to drive awareness. So we're really excited about our continued growth and market penetration and the awareness in general in the markets that we're in as we grow.

Operator

Our next question is from Lauren Silberman with Deutsche Bank. Please proceed.

Lauren Silberman

Hey, thanks and congrats on the quarter. Same-store sales, really strong momentum continued. I want to ask how you're thinking about the composition of comp as we move into 2025, traffic obviously strong for marketing, seeing an offset negative mix, how are you thinking that balancing traffic in that negative mix component? Should we expect the mix piece to improve over time? And anything that you can expand on that we may not be seeing at sort of face value?

Robert Lynch

Yeah. I mean, I would just say, I think as we called out in the script that the mix is really just a function of our continued investments in promotions. We have seen strong performance on our LTOs and on our premium items. So we're going to continue to make those investments. That's going to be a sort of our model moving forward.

Traffic, that's the flip side of that, right? Those investments and promotions and marketing are helping us keep flat to positive traffic in an environment where, as we all know, traffic is really hard to come by. So we are going to continue to strike that right balance. We've been really excited about our ability to mitigate some of the inflation we've seen with pricing and continue to drive traffic -- positive traffic despite that pricing. So we think that we have the ability to continue to strike that balance moving forward regardless of what the macroeconomic situation looks like.

Operator

Our next question is from Christine Cho with Goldman Sachs. Please proceed.

Christine Cho

Hi. Congrats on a great quarter. I just wanted to talk a little bit about your pricing strategy going forward, given kind of a more subdued inflationary pressure as well as increased kind of consumer price sensitivity. I know the kiosk has been a really good mix support. But what are some of the ways that you can help support price/mix going forward without kind of taking direct price hikes? And also, if you can kind of elaborate on the performance of the Black Truffle kiosk and specifically how it's impacted the mix in the quarter would be great? Thanks so much.

Rob Lynch

Yeah. I'll let Katie talk specifically to pricing and mitigating inflation. But what I can tell you is that, pricing has been, obviously, a big part of the restaurant industries growth in the last few years as we faced unprecedented inflation.

As we look ahead, the fact that we don't have to take pricing to the same extent is only going to benefit us. So that we can continue to improve our value equation with the investments we're making in marketing, the investments we're making in our culinary calendar to drive new product innovation and drive mix through increased attachment through a strategic product calendar.

So I'm really excited about moving forward without having to take as much pricing. But I'm also confident in what we've shown over the last year is that if we do see unforecasted inflationary environment, we can take pricing and still drive top line sales growth through traffic management with our marketing investments.

Katie Fogertey

Great. And yeah, I'll just add on that. Just as a reminder, early this year, we implemented two pricing strategies. So first of all, was lifting the digital price and we remain under priced relative to the competition on digital channels that this was a great step for us to help mitigate that extra cost pressure in that channel. And then we also implemented in March about 3.5% price increase, but that was really inclusive of the 7% price that we took in California to help offset the fast starts.

And then looking forward here, we recently just basically matched in October, late October, the 1.5% price that we were rolling off with another 1.5% price increase. This is really to help us offset the inflationary pressures that we're seeing primarily in beef and a little bit of risk that we're seeing here into next year.

But what I will say is that the supply chain team that here at Shake Shack is doing a really amazing job at identifying strategies, increasing our supplier base, looking at freight opportunities to help us navigate what is continued inflationary pressures on our business.

And then other strategic opportunities that we've been focused on to help take down our total cost to serve we talked about what we've been doing a little bit in labor. The hourly labor refinance that we're making are helpful, but there's also a slew of other initiatives that we have either in test or underway in operations that we think enhances the guest experience and allows us to dedicate more of our or time to facing guest-facing activities, but at the same time, also reduces our total cost to serve.

So, there's a lot of things that we're doing organically to help us address the inflationary pressures. We do think that we still have continued pricing power across various channels, but we also are leaning on strategic alternatives as well.

Operator

Our next question is from Brian Mullan with Piper Sandler. Please proceed.

Brian Mullan

Thank you. Just a question on development. As it relates to the 2025 pipeline, could you just speak to how many drive-thru units you're planning for? And related to that, can you just speak to how that -- the new class will incorporate any learnings the company has already had or Rob, maybe any new insights you or Stephanie might have brought to the table will be incorporated into the drive-thrus going forward? Any thoughts would be great.

Rob Lynch

Yes, Brian. I don't think we're necessarily disclosing the mix on drive-thrus. What I can tell you is that drive-thru is a big part of our strategy moving forward. And as Katie just highlighted, we're working -- really our number one priority operationally is to improve our process flows and increase our speed of service.

And that's going to be disproportionately impactful on our drive-thru business, and we're continuing to test both optimizations to the order zone and how we represent the brand and our menu on our digital and static menu boards and then also in the delivery zone and how we bring the food to the customer and how long it takes us to execute all of that. So, there's a lot of work going on to significantly improve our speed of service, which is the number one thing we need to optimize through the drive-thru.

As I look to the future, even beyond 2025, formats and improved kitchen flows and optimizations are all part of the things we're exploring for us to be able to go into different types of real estate in different markets and succeed and succeed and deliver great operating productivity and restaurant margins regardless of the format that we build. So, that is a big part of our strategy moving forward.

Operator

Our next question is from Andrew Charles with TD Cowen. Please proceed.

Andrew Charles

Great. Encouraging Worth It campaign that we saw launched this month, and I had a two-part question about that. So, first, were you able to see in October outperformance in the New York and Miami markets within same-store sales versus what you reported?

And then secondly, Rob, I'm curious what do you need to see before you roll out that campaign to other markets as well?

Rob Lynch

Great question. So we made a strategic decision not to put any type of promotion or incentive on that ad. Most ads in the marketplace in this industry has some type of price point and promo to drive a short-term purchase. And where we are in our marketing life cycle, we're still at the infancy level in terms of really defining our brand in the hearts and minds of our target customers across the country.

And even in New York, where we have a huge amount of awareness of Shake Shack really defining how Shake Shack stands out and is differentiated from our other competitors is really key to the long-term value proposition that we're going to offer to our customers.

So, as I mentioned, we are seeing positive movement on our marketing metrics, both from an awareness, consideration and equity score. And so there are a lot of strong indicators that what we're doing is working. I would tie that back to sales will be an ongoing process for us and will drive kind of how we optimize, how we show up in the markets as we scale this campaign moving forward.

Operator

Our next question is from Brian Harbour with Morgan Stanley. Please proceed.

Brian Harbour

Thanks. Good morning guys. The lower wait times you talked about, would you kind of attribute that to I don't know, maybe it's freeing up your staff just with kiosks or such or anything else you'd call out that drove that? And then my sense from your comments, Rob, was that a lot of stuff on like kitchen process and whatnot is still to come. And so do you have targets for kind of how much wait time should continue to improve and when we should expect to see that?

Rob Lynch

Yes. I mean, we're still in the early stages of optimizing all of this work. But what I will tell you is that from an operations standpoint, we're focused on 3 or 4 things. Katie talked about our labor utilization and making sure that we're getting the most productive use of our labor hours.

Another big thing that we're focused on because with 330 Shacks opening 40 to 45 company restaurants a year, we really need to develop our leaders, our restaurant leadership talent pool. And so we're spending and investing and focused on the training and development necessary to really create a pipeline of leaders, not just at the GM level but below the GM level. And I think that company -- that level of leadership and management is only going to benefit us speed and service standpoint.

And then lastly, which is really just blocking and tackling, but it's a little bit new to our organization is really staying focused on what we're going to measure and how we're going to create a performance and accountability culture around what we measure. And so that is a mindset and a culture of performance that is going to permeate down through the organization.

And I think just that alone is really helping to drive some of the short-term improvements that we're seeing in service times and some of the other process improvements, training and development and even longer term kitchen flow and equipment optimization are going to really continue that momentum and allow us to continue to improve beyond where we are today.

Operator

Our next question is from Sharon Zackfia with William Blair. Please proceed.

Sharon Zackfia

Thanks. I wanted to kind of come back to the strategic product innovation dynamic that you're looking towards? And I'm sorry if you answered this, I accidentally hung up for a part of the call and I had to dial back in. But are there gaps in the menu that you're looking to address where you think Shake Shack could be more relevant? And then secondarily, with the wait time improvement, did you see that across channels in the quarter, meaning like walk in delivery and drive-thru? Thanks.

Rob Lynch

So I wouldn't say that there are gaps in our core menu. I think there are opportunities for our core menu to work more harmoniously with our LTOs and our product innovation to drive mix benefit through complementing both the core menu with our innovation. And that's the strategic product calendar that I talk about that is kind of core to what the -- how the QSRs drive comp and -- but still something that we're developing here to strategically make sure that we have our menu -- our core menu and our LTOs optimize. So that's the work that's moving forward.

On the wait times, I would just tell you, we're seeing overall improvement. I don't think we're going to get into each of the different channels. But for us to be able to make a big impact. We have to improve our channels -- across our channels, both from how we service the dine-in business, how we deliver drive-thru as it becomes a growing bigger part of our business.

And obviously, even with our delivery -- third-party delivery transactions, those are also becoming a big part of our business as well. So we need to make sure that we're delivering the customer service that our guests expect across each of those channels.

Operator

Our next question is from Peter Saleh with BTIG. Please proceed.

Peter Saleh

Yes. Great. Thanks and congrats on a great quarter. I wanted to ask about the restaurant-level margin outlook for the fourth quarter of 22%, and it's substantially higher than what we were modeling. I'm just -- can you give us a sense, does that reflect the benefits of the new labor model that you guys have been working on and looking to roll out? Or is that more of a 2025 initiative? And then also, how do you want us to think about 2025 margins at this point given all the initiatives you guys have in place on throughput and price?

Katie Fogertey

Yes. Thank you. So the 4Q guidance we have for restaurant margin expansion, it's about 220 basis points higher than last year, and it's showing significant progress. There were -- I would just also caveat that with last year at this time, we started to see kind of higher beef inflationary pressures. So while we expect these to be continued inflationary pressure this year, kind of that incremental step up, it's a little bit more muted.

And we also have a number of new Shack openings happening later in the quarter. So that always can cause a little bit of noise. But what you're really seeing here is us, first of all, if you look at top line, driving top line momentum in the business, and through the focus that we've had in supply chain efficiencies and also in operations, really being able to bring more of that down to the bottom line.

We're not giving guidance for next year. There's still a lot of puts and takes here around inflationary pressures on -- particularly with beef, but we will let you know at due course what that guidance will be.

Operator

Our next question is from Jake Bartlett with Truist Securities. Please proceed.

Jake Bartlett

Great. Thanks for taking the question. Reminding to follow-up on the restaurant level margin opportunity. Rob, my impression was that the margin expansion opportunity is a really big one for Shake Shack. And back when the activists were involved 1.5 years ago, that seemed to be their focus as well, and you're talking about really significant opportunity on margins.

So my question is, do you view the margin opportunity as very large is really meaningful at Shake Shack? So far, it sounds like you focus much more on the top line, which obviously does drive margins at the end of the day. I'm just trying to understand what you view as the opportunity with margins?

And then within that, maybe what inning you are on what you've identified so far, for instance, in the supply chain that is -- you're benefiting from that already? Is there much more to come? If you could just give a little more detail on the longer-term plan and vision for margins?

Rob Lynch

So as Katie just said, we're not guiding for next year. So we're not going to talk about necessarily how much growth in the margin there is -- how much potential growth in the margin there is. But I will tell you that we are focused on delivering long-term productivity in our restaurants. And there's a lot of easy ways to come in and draw short-term margin growth. I mean, we could come in and just cut the labor significantly and compromise our guest service and compromise our team member development, and that's not the model.

So we are not -- our plan is not to come in and deliver a big bang margin expansion through doing things that impact us in the long-term. Our focus is 100% on driving a performance and accountability culture, driving process improvements and training and development of our teams. And all of those things continue to drive sustained margin enhancement. We've seen it really for the last 1.5 years, and I think it's going to continue to improve as we evidenced in our guide for the fourth quarter.

So those are -- I know you talked about I'm focused on the top line. We are marketing is a big part of our strategy. But there's not an hour in this building that goes by where we're not talking about restaurant productivity. And Stephanie, our new COO, I hardly ever see orcas in the field so much, making sure that this mindset and this performance culture is permeating through all the levels that need to get down to the Shacks, and that's why we're seeing such great results.

And then the last piece on supply chain. Look, Shake Shack is what it is because of the quality of our ingredients and the quality of our food. We are never going to impact that. We are focused on being a fine casual restaurant, delivering fine dining food through a fast casual format. And so our supply chain optimizations are about efficiency and productivity, not about changing any of the ingredients or degrading the quality of our food. And so I'm very pleased with our team's ability to find ways to be more productive, help us maintain or grow our margins despite inflation without negatively impacting our food.

Operator

Our next question is from Sara Senatore with Bank of America. Please proceed.

Sara Senatore

Thanks. Just a couple of clarifying questions. The first is just on the store closures. You mentioned, I think you said \$17 million in trailing 12 -- trailing four quarter revenues but immaterial to operating profit. Could you just quantify what that means in terms of -- it sounds like it would probably be a tailwind to restaurant level margin rates just because they are below average. I couldn't -- I don't know how precise the numbers were, but is it maybe 30 basis points, something like that. So I just wanted to quantify that and then question on the license business. That store count came down a little bit, I think. And if you could maybe just talk about that. I don't know if there's international, some of the geopolitical tunnel that might be affecting it or anything worth noting there? Thanks.

Katie Fogertey

Yeah, sure. So on the nine Shacks that we closed, we disclosed that, that was -- those Shacks in total generated about \$17 million in sales over the past four quarters. What I'd say is that we're not disclosing the actual cost impact of that. But these restaurants, not only were they below company average profitability, they were actually loss-making. When you roll it up in total, it's not a material part of our overall profitability, but it is a benefit to our restaurant profit margin line now that they are closed. Do you want to take the license?

Rob Lynch

Yeah. On the license side, we've had a couple of markets where we've had some timing issues on some Shacks that we expected to open up in Q4 are now going to be pushed to Q1. I think we've already disclosed on the last call that we are seeing, there are some headwinds in China and the Middle East, given the macroeconomic and geopolitical challenges in those markets, but they're still our fastest growing international markets.

So we have a lot of confidence in our partners there. We've got amazing licensee partners who are continuing to build despite those challenges because of the results that they're seeing. So license is going to continue to be a bigger and bigger part of our business. We have a ton of white space, a ton of opportunity to go and open up new markets with new partners, while continuing to grow and get more productive with our current partners through format innovation and menu innovation. So, really bullish on our license business moving forward.

Operator

Our next question is from David Tarantino with Baird. Please proceed.

David Tarantino

Hi. Good morning. Rob, I wanted to ask about the strategic product innovation. And maybe I'm being a little dense here, but could you maybe explain exactly what you're thinking with that strategy and maybe provide an example that brings it to life? Thank you.

Rob Lynch

Yeah, David, I'm probably not going to talk about future innovation, but I can give you an example. I mean, right now, Black Truffle Burger and the Black Truffle Fries are representative of the kind of innovation that makes Shake Shack special. And I would also say the Korean Chicken Sandwich is another one. The things that you're just not going to get anywhere else executed with excellence. And I'm challenging the team to look at all kinds of burger and sandwich innovation.

And some of that could be proteins. Some of that could be flavor, some of that could be culinary driven innovation, also side items. Right now, we've got French fries and there's all kinds of opportunities. So when I talk about product innovation, I've kind of opened up the aperture for the teams to explore what could be next. And I've kind of pulled off any guardrails that might have been in place.

So I'm really excited. I think product and food innovation has been a part of my DNA for a long time. And we've got a great amazing team here that has an amazing amount of culinary prowess. And so I'm looking to kind of unlock that across all the different platforms across our menu, whether it's sandwiches, shakes, beverages or side items.

Operator

Our next question is from Andy Barish with Jefferies. Please proceed.

Andy Barish

Hey, good morning guys. Just on the development side of things, I think you've noted some infill pressures in a couple of the big coastal markets. Is there anything we should expect changing on that front as we look out to the 2025 development? Or do you see the brand and marketing awareness in those markets being able to offset some of that sales transfer, if you will?

Rob Lynch

The more penetrated historical markets because of some of the format innovation that we're looking at. Just the way we've changed a little bit of our strategic purview where we definitely have greenfield white space growth markets that we're going to go in and still be able to build out a lot of these big flagship core Shacks and deliver great performance without a lot of cannibalization.

But in the more highly penetrated markets, I think there's a lot of infill opportunity. And I think that our drive-thrus and the other formats that we're looking at will help us facilitate that. So we're still building in New York, New Jersey. We're still building in California. We're building in markets that are already really penetrated, but we're maybe doing it in a little bit of a different way that still allows us to drive great restaurant margins, but in a little bit of a different way than we might have historically.

Operator

Our next question is from Jim Sanderson with Northcoast Research. Please proceed.

Jim Sanderson

Thanks for the question. I just wanted to go to unit growth. I think your growth guidance for 2025 implies a slight pickup in company-operated unit growth. Wondering how we should look at that as a run rate going forward, if it's the percentage that's most relevant or the actual number of units as we're trying to imagine the total size of Shake Shack in the US going forward? Thank you.

Rob Lynch

Thanks for the question, Jim. Our 2024 class of Shacks has done really well in terms of their sales performance. And it's also doing really well in terms of the margins given some of the increases in productivity that we have implemented, but also that we see moving forward with some of the things we've talked about today. So that gives us a lot of confidence.

And then lastly, the build costs. We continue to improve the build cost, a decrease of 10% this year, continuing to work on productivity opportunities looking forward into next year and beyond. So, we are really bullish on the returns - the cash-on-cash returns that we can see from continuing to build new Shacks -- new company-operated Shacks.

And so we are going to continue to increase in 2025 and unless something changes dramatically, we're going to continue to double down on development. And we're building the infrastructure and the resources internally, where we're making our SMB investments in G&A, a lot of that is in development so that we can continue to have the real estate resources to find the sites and the construction resources to get them opened up.

And then lastly, I'll talk -- the last thing I'll say is that the training and development that we talked about in the Shacks and operations. That's probably the most critical piece. We need leaders to be able to continue to open up our new Shacks with excellence. So, we're definitely focused on that as well.

Operator

Our next question is from Daniel Guglielmo with Capital One Securities. Please proceed.

Daniel Guglielmo

Hello everyone. Thank you for taking my question. You all have a pretty good vantage on consumer trends in the U.S., and I know you also have a pretty robust internal modeling process. Were there any regions or states that came in stronger than you all were expecting or modeling? And then on the flip side, were there any that came in softer? Thank you.

Katie Fogertey

Yes. Thanks. So, we outlined in our prepared remarks, the number of areas where we had double-digit comp growth that includes parts of -- in Florida, in the Southwest and Southeast. And I would say, overall, we're really pleased with the trends that we saw sequentially, every region, we have either held the same, but most of them increased sequentially. And then also by income cohort, we saw sequential improvement in high and low and medium income as well.

So, let's say, across the board, just a really strong quarter, a really testament to the success that our teams are having at driving sales through marketing initiatives and the work that our teams are doing on operations to help better serve our guests.

Rob Lynch

And just to build on Katie's comment on income cohort, the one thing I will share is that our data shows that we're one of the few brands despite the pricing we've taken over the last year. One of the few brands to actually improve our value equation over the last year. So it does feel like all the initiatives that the team have put in place around service and speed, coupled with the great food that we continue to deliver is driving a stronger value perception, which is allowing us to continue to grow, both at the top and bottom of the income cohorts.

Operator

Our next question is from Jeffrey Bernstein with Barclays. Please proceed.

Jeffrey Bernstein

Great. Thank you very much. Actually, just two follow-ups. The first one, Katie, I know a lot of people have been asking about the restaurant margin and the opportunity, and I know you're not guiding, but I'm just wondering if maybe as an alternative, you can give maybe a range of performance across your system that you're seeing today, whether it's quartiles or otherwise, just to demonstrate where some of the better markets or stores are sitting at relative to the opportunity?

And then my other one is just, Rob, you mentioned -- you just mentioned the income cohorts and kind of value. I'm just wondering with the lower-end quick-service category, doing much more aggressive discounting and seeing improving trends. I'm just wondering how you think about that in terms of competition, whether there's a chance you would bundle just to communicate value oriented. Thank you

Katie Fogertey

Thanks for the question. So on our restaurant margin line, we've been pretty consistently sharing over the past 1.5 years to two years, the strategies that we've been working on in order to grow our -- be more efficient in our restaurants.

So on cost of goods sold, despite continued inflationary pressures, we've been focused on identifying more ways to deliver value, whether that's adding additional suppliers and optimizing our freight and certainly getting denser in market allows us to have benefits of scale as well. And that we will continue that line of work for sure. And as we open up more restaurants and get denser and develop markets, we'll be able to have more cost savings opportunities on that side as well as just organically.

In the labor side, we've also shown substantial progress on this side over the past couple of quarters. Some of this is just really basic blocking and tackling of making sure that our teams are aligned and working closer with operations. And then we've been doing more with the labor scheduling model, which we put into place late in the third quarter. And then certainly, with Stephanie, our new COO in place, it's very in the weeds working with all of our team members here across Shacks and identifying additional opportunities. And we'll share that with you when it's the right time. But I'm very confident in the work that is being done today to help us continue to drive profitability in our restaurants. So, the overarching unknowns out there will be around inflationary pressures just broadly, specifically does call out beef, and then also just top line with macro uncertainties. But we're really excited and proud of the work that is being done today.

Rob Lynch

Yes. And just to close the loop on the QSR value dynamic right now. We obviously don't have national advertising. So we're not out there promoting \$5 bundles or \$10 bundles. But we are delivering targeted digital ads and promotions across our footprint. We do that in a very targeted surgical way by ZIP codes and with our guest recognition technology capabilities to be able to make sure we're sending it to the right people.

So, we are delivering a great value prop through our targeted channels. But really where we're focused is improving the experience, improving the numerator, like improving the quality of food that we deliver, the faster it is, the hotter it is, the better customer service and the better experience our customers have. So, we're really focused on that numerator, but we are delivering surgical targeted digital promos that do address some of the price gaps for the lower income cohorts that we also want to serve.

Operator

Our final question is from Rahul Krotthapalli with JPMorgan. Please proceed.

Rahul Krotthapalli

Good morning guys. I have a question and a follow-up. Can we discuss on how you think about the new stores opening in the existing delivery trade areas? New York City was set to have an issue before on the delivery sales transfer. Is there any change to the infill or real estate strategy after recent store closures as you approach this channel over time?

Rob Lynch

Yes. I would just say that we continue to get even smarter about how we open new Shacks in markets where we currently have penetration to minimize cannibalization and optimize operational efficiencies. I mean, we're only going to get more efficient as we penetrate these markets. We get supply chain efficiencies, we get operating efficiencies, we get marketing efficiencies. So penetrating these markets to a larger degree, isn't a negative. It's actually a positive. And as we scale, we're only going to see continued benefit to the restaurant margin lines in these markets.

Operator

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

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