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EPS of -\$0.07 **misses by \$0.10** | Revenue of \$85.00M (2.95% Y/Y) **misses by \$2.60M**

The ONE Group Hospitality, Inc. (NASDAQ:[STKS](#)) Q1 2024 Earnings Conference Call May 7, 2024 4:30 PM ET

Company Participants

Tyler Loy - Chief Financial Officer

Manny Hilario - President & Chief Executive Officer

Conference Call Participants

Jim Salera - Stephens Inc.

Mark Smith - Lake Street

Michael Symington - Wedbush

Roger Lipton - Lipton Financial

Operator

Greetings, and welcome to The ONE Group First Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference call over to Tyler Loy. Please go ahead.

Tyler Loy

Thank you, operator, and hello, everyone.

Before we begin our formal remarks, let me remind you that part of our discussion today will include forward-looking statements. These forward-looking statements are not guarantees of future performance, and you should not place undue reliance on them. These statements are also subject to numerous risks and uncertainties that could cause actual results to differ materially from what we expect.

Please also note that these forward-looking statements reflect our opinion only as of the date of this call. We undertake no obligation to revise or publicly release any revisions of these forward-looking statements in light of new information or future events. We refer you to our recent SEC filings for a more detailed discussion of the risks that could impact our future operating results and financial condition.

During today's call, we will discuss certain non-GAAP financial measures, which we believe can be useful in evaluating our performance. However, the presentation of these measures or other information should not be considered in isolation or as a substitute for results prepared in accordance with GAAP. For reconciliations of these measures, such as adjusted EBITDA, adjusted net income, restaurant operating profit, comparable sales and total food and beverage sales at owned and managed and licensed units to GAAP measures, along with the discussion of why we consider these measures useful, please see our earnings release issued today.

With that, I'd like to turn the call over to Manny Hilario.

Manny Hilario

Thank you, Tyler, and hello, everyone. We sincerely appreciate you joining us today and for your interest in The ONE Group.

To begin, I would like to express my gratitude to each of our dedicated team members, including the nearly 6,500 new teammates who joined The ONE Group last week with the closing of the acquisition of Safflower Holdings Corp., the parent company of the Benihana and RA Sushi restaurant brands. For the remainder of this call, we will be referring to Safflower Holdings as Benihana. Thanks to our remarkable teams, we have solidified our leadership position in the high end and polished casual vibe dining.

Let's discuss highlights from this first quarter 2024 and provide an update on the strategic initiatives that shaped the quarter. First, despite a challenging sales environment, we grew sales 3% to \$85 million, driven by the strength of our company-owned new restaurants, which contributed significant revenues at margins above the rest of the system. Second, with only moderate pricing and stickier-than-expected inflation, we kept restaurant-level margins intact at 16%. This was enabled by the cost-saving initiatives that we enacted in the fourth quarter of last year, which generated approximately \$3 million in restaurant operating profit throughout the quarter. Next, we managed G&A effectively as G&A, excluding stock-based compensation as a percentage of revenue improved by 20 basis point year-over-year. All of this resulted in \$10.5 million in adjusted EBITDA, nearly in line with last year despite the tough consumer environment experienced throughout the industry.

During the quarter, we celebrated the opening of our 28th STK Steakhouse. The restaurant is located in Washington, D.C. across from the Walter E. Washington Convention Center and inside the Marriott Marquis Hotel. The opening of this new STK marks an important step in The ONE Group's strategic expansion initiatives and long-term growth strategy. We are thrilled to be welcoming new guests to this exquisitely designed restaurant and providing them with a truly memorable dining experience.

Looking ahead, we remain laser-focused on continue to drive top-line growth while further enhancing operational efficiencies. Key strategic priorities for 2024 include:

First, a focus on driving sales. Similar to others in the industry, during the first quarter, we experienced a decrease in comparable store sales from a choppy and challenging consumer environment. And as a result, we have focused on efforts on delivering value, coupled with strong execution. We continue to promote our \$3, \$6 and \$9 Happy Hour menu at both brands, and our \$69 and \$39 Steak Night America offerings at STK and Kona Grill, respectively. In addition, to cater the folks looking for higher-end experiences, we continue to innovate on our culinary program with premium product lines. To amplify these value-driven and experiential offerings we are leveraging our robust digital marketing capabilities supporting these strategies, coupled with a relentless focus on delivering fantastic guest experiences. We are confident that we can successfully navigate the current challenging sales environment and drive sustainable sales growth.

Our second key priority is to improve Kona Grill margins. At the end of 2023, we performed an in-depth review of our Kona Grill portfolio of restaurants and the term that about a quarter of the 24 restaurants we acquired are underperforming due to challenging real estate. The bifurcation of performance continued into the first quarter as our core base of restaurant saw significantly healthier margins than these other locations. As previously mentioned, we will address each of these locations on a case-by-case basis. As we look at our pipeline of new units, we expect the new Kona Grills to have a target AUV of \$5 million and a 70% restaurant-level margin.

For both the STK and Kona Grill brands, we have implemented several key initiatives to improve restaurant operating profit and overall profitability. Managing menu and product mix is one, enhancing purchasing efficiencies for both in food and operating supplies, maximizing productivity through smart scheduling practices, evaluating all third-party vendor relationships and reduced travel costs. We saw these initiatives take hold during the quarter as we were able to maintain margins. We are confident that this momentum will continue throughout 2024 as we further optimize operations.

Our third key priority is to rely on self-funded growth for company-owned operations. As I previously mentioned, this year, we have opened one company-owned STK in Washington, D.C. For the remainder of the year, we expect to open an additional five to seven new STK and Kona Grill venues, which includes one to three company-owned STKs, two company-owned Kona Grill and one to two managed or licensed units. We also plan to open one to two company-owned Benihana and one company-owned RA.

There are currently four company-owned restaurants under construction in the following cities: an STK restaurant in Aventura, Florida at the Aventura Mall; a Salt Water Social, which is a high-end seafood vibe dining restaurant, they'll be located in Denver, Colorado in the Cherry Creek neighborhood; a Kona Grill restaurant in Tigard, Oregon at the Bridgeport Village; and RA Sushi restaurant in Plantation, Florida. Over the long term, we plan on growing three to five new units of each of our growth brands, STK, Kona Grill and Benihana. We view this as a proven and scalable international platform with compelling white space. We see an addressable market of over 800 venues, which includes 400 restaurants for Benihana in the U.S. alone, 200 STKs and 200 Kona Grills. We are clearly in the early innings of a robust growth strategy.

Our fourth key priority is the successful integration of Benihana. This acquisition not only aligns with our vision of being the undisputed global leader in vibe dining, but it will also generate tremendous synergies. From our ability to manage commodity cost at scale, drive many mix through culinary innovation, leverage our combined digital databases and digital capabilities and utilize our robust reservation management system, we have a tremendous opportunity to create value for our shareholders through this combination of top entertainment brands.

Lastly, our fifth key priority is to continue to return value to our shareholders through share repurchases. We generate tremendous cash flow, and we believe there is an opportunity to leverage our internally generated cash to create balance between growth and shareholder accretion via share count reduction. To this end, earlier this year, the company's Board of Directors authorized a \$5 million share repurchase program on top of the \$50 million program that was already completed last year.

To conclude, I'm pleased with how we have kicked off the new year despite navigating a particularly challenging restaurant environment. This is a testament to the fantastic job our team is doing. We believe that our strong leadership team combined with our strategic initiatives, positions us well to navigate the evolving market conditions and capitalize on growth opportunities. We are excited for the future, and we will remain focused on executing our strategy and enhancing shareholder value.

I will now turn the call over to Tyler.

Tyler Loy

Thank you, Manny.

Let me start by discussing our first quarter financials in greater detail. Total GAAP revenues were \$85 million, increasing 3% from \$82.6 million for the same quarter last year. Included in our total revenue is our owned restaurant net revenues of \$81.5 million, which increased 3.7% from \$78.6 million for the same quarter last year. The increase was primarily attributable to the opening of six restaurants since July of 2023. This was partially offset by a 7.9% decrease in comparable sales, consisting of a 6.8% decrease at STK and a 9.7% decrease at Kona Grill.

Management, license and incentive fee revenues were \$3.5 million, decreasing 12.3% from \$4 million in the first quarter of 2023. The decrease was primarily attributed to decreased revenues at our STK restaurants in North America and the exit out of STK Westminster as we consolidated our London operations in the fourth quarter of 2023.

Owned restaurant cost of sales as a percentage of owned restaurant net revenue improved 100 basis points to 23% in the [fourth] (ph) quarter of 2024 compared to 24% in the prior year primarily due to operational cost reduction initiatives, product mix management and pricing offset by cost inflation. Owned restaurant operating expenses as a percentage of owned restaurant net revenue reached 130 basis points to 60.9% in the first quarter of 2024 from 59.6% in the first quarter of 2023, due to fixed cost deleveraging and operating cost inflation, partially offset by operational cost reduction initiatives.

Restaurant operating profit was 16.1% for the first quarter of 2024, compared to 16.4% in the first quarter of 2023.

On a total reported basis, general and administrative expenses were flat at \$7.5 million for the first quarter of 2024 and 2023. When adjusting for stock-based compensation, adjusted general and administrative expenses were \$6.2 million in the first quarter of 2024 and 2023.

Pre-opening expenses were \$2.9 million compared to \$1.3 million in the prior year. The increase was related to payroll, training and non-cash pre-open rent for STK Washington, D.C., which opened in March 2024, and STK and Kona Grill restaurants currently under development.

Interest expense was \$2.1 million in the first quarter of 2024 compared to \$1.8 million in the first quarter of 2023. Income tax benefit was \$0.3 million in the first quarter of 2024 compared to income tax expense of \$0.2 million in the first quarter of 2023.

Net loss attributable to The ONE Group Hospitality, Inc. was \$2.1 million or \$0.07 net loss per share compared to a net income of \$2.6 million in the first quarter of 2023 or \$0.08 net income per share. Adjusted net loss was \$0.6 million or \$0.02 adjusted net loss per share compared to an adjusted net income of \$3.2 million in the first quarter of 2023 or \$0.10 net income per share.

Adjusted EBITDA for the first quarter attributable to The One Group Hospitality, Inc. was \$10.5 million compared to \$10.9 million in the first quarter of 2023. We have included a reconciliation of adjusted EBITDA and adjusted net income in the tables in our first quarter 2024 earnings release.

During the first quarter, our Board of Directors authorized an additional \$5 million share repurchase program. However, there was no stock repurchases in the first quarter of 2024.

Now, I would like to provide some forward-looking commentary regarding our business. This commentary is subject to risks and uncertainties associated with forward-looking statements as discussed in our SEC filings. We always remind our investors the actual number and timing of new restaurant openings for any given period is subject to a number of factors outside the company's control, including macroeconomic conditions, weather and factors under control of landlords, contractors, licensees and regulatory and licensing authorities.

Based on the information available now and the expectations as of today, we are updating our 2024 targets to include the addition of Benihana. The guidance includes projections for Benihana from May 1, the date of the acquisition, until the end of the year.

Beginning with revenues, we project total GAAP revenues of between \$700 million and \$740 million, which consists of an additional \$340 million to \$360 million for the addition of Benihana. Managed, franchise and license fee revenue are expected to be between \$17 million and \$19 million which consists of an additional \$2 million to \$3 million for the addition of Benihana.

Total owned operating expenses as a percentage of owned restaurant net revenue of approximately 83%. Total G&A, excluding stock-based compensation of approximately \$40 million. Adjusted EBITDA of between \$95 million and \$100 million. Restaurant pre-opening expenses between \$7 million and \$9 million. An effective income tax rate of between 5% and 10%. Total capital expenditures, net of allowances received from landlords of between \$50 million and \$60 million. And finally, we plan to add eight to 11 new venues in 2024.

Based on the guidance discussed, coming out of 2024, our annual run rate system-wide F&B revenues will be in excess of \$1 billion. Our run rate GAAP revenues will be approximately \$950 million, and our run rate adjusted EBITDA will be greater than \$140 million.

I will now turn the call back to Manny.

Manny Hilario

Thank you, Tyler, and thank you all for your time today and interest in The ONE Group. We are in the early stages of our long-term growth strategy as we continue to build a portfolio of high-volume brands with compelling returns for our shareholders. We've recently added Benihana and RA Sushi, two vibe and entertainment dining brands that will diversify and strengthen our industry-leading portfolio of world-class experiential restaurant concepts and blend perfectly with STK and Kona Grill. This is an exciting time to be part of this company, and we appreciate your support.

Tyler and I would be happy to answer any questions that you may have. Operator?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Your first question comes from Jim Salera, Stephens Inc. Jim, please go ahead.

Jim Salera

Hey, guys, good afternoon. Thanks for taking our question. Manny, I was curious if you could maybe level set what you saw from the consumer during the quarter, and just kind of run that versus -- the results versus your expectations? I don't know we hear a lot about consumer engaging and value-seeking behavior, especially with restaurants. And so, if you can just maybe give us an idea for the appetite for some of the experiential dining that you talk about and how that jibes with what the consumer is engaging in with kind of a value-oriented lens right now?

Manny Hilario

Yeah. So, great question. I think as we mentioned in our earlier -- last quarter's call, we certainly see choppiness in the sales environment. So, it's a little bit more uneven environment in terms of predictability on sales week-over-week. So, it's a little bit choppier. In terms of the consumer behavior, we clearly see consumer gravitating towards the Happy Hour, our \$3, \$6, \$9 price points are holding up very well. So, we do see trading to Happy Hour.

And then, within the dinner sets at STK, we also see -- we actually see two things. We have a group of consumers that are actually trading and sharing more at the table, and then we have a group of consumers that's still trade up to the premium items like Wagyu. So, we do have a little bit of a bifurcated behavior within STK.

So, I would say that's kind of what I've been noticing is a lot more attraction to the entry price points in the menu. But at the higher end, I still see a lot of consumers opting for the high-end product.

Jim Salera

Okay. Great. And then maybe if I can just ask a question on the new unit side. Can you just give us an update on new unit environment, permitting, any labor delays, anything? I know depends on where you're opening stores, obviously, but we've heard some other restaurant operators may have some delays in getting new unit openings, whether it's labor shortages or permitting delays. Just anything you can talk about what you're seeing on your end?

Manny Hilario

Yeah. Another great question. Historically, we always plan three to six months for the permitting cycle. Now, we actually think it's nine months. We've actually added three extra months to the permitting cycle. They are longer. There seems to be a lot more back and forth and the responses seem to be a little slower in terms of when we sent in submission. So, I would say that's still part of the environment.

But generally, new units and unit development -- the one thing I will tell you is that when we open new stores, there's a lot of excitement for new stores. So that's the upside on development right now is when we open great locations like we just did in Washington, D.C., we see an incredible amount of business coming to us because I think the consumer right now, in addition to -- they're looking for something different and experiential. So, I think that any time we open one of our resins, we do get rewarded with some very strong upfront revenues.

Jim Salera

Perfect. Thanks, guys. Appreciate the color. I'll hop back in the queue.

Manny Hilario

Thank you, sir.

Operator

Thank you. Your next question comes from Mark Smith, Lake Street. Mark, please go ahead.

Mark Smith

Hi, guys. Similar to the last question, just on consumers. Just curious, as you look at -- actually, first, can you just talk any more about Kona Grill consumers maybe more so than STK and any changes in behavior during the quarter?

Manny Hilario

I mean, actually, for the quarter, Tyler and I were talking about this earlier. We actually -- I would expect that they would have traded down on the P-mix and actually our P-mix trade only down 3 points. So, we don't see a lot of trade down at Kona Grill. So, I would say that consumer actually has not traded down as much as I would have expected. But the reality of it is they still are gravitating towards, as I mentioned earlier, the \$3, \$6, \$9 price points on the Happy Hour. And then we also now feature \$39 Steak Night America at Kona Grill.

So, I do think that right now, value is king and that the consumer will gravitate towards that, except as I mentioned earlier, higher-end consumer still is going for the Wagyu and still ordering the premium product. But the other consumers are definitely trading to the value propositions.

Mark Smith

Okay. And as we think about the Benihana consumer, any initial thoughts that you have on potential behavior if maybe they lean more towards more -- or will behave more like that higher-end STK consumer or maybe more like the Kona consumer? Any broad thoughts you have would be great.

Manny Hilario

Yeah. I mean, so my early observation is lots of celebrations. So, they're still willing to go after the premium or the top items on the menu. So, my view so far with the brand is that people -- the behavior of Benihana has not really changed, if you will. I do think that the upside at Benihana, though, is on premium products. I think that there's a lot of room for us to introduce some of the premium products that we have access to through our STK program, particularly Wagyu.

So, I think you'll see us introducing seasonal products that are a little bit higher price point. And I think there is a group of consumers in that brand that will opt to it. As a matter of fact, we know that because the demographic studies that we've done do show that they do have some higher-end consumers in the brand. It's a pretty broad-based used brand, because it's celebration. So, we think there's actually a pretty large upside for us as we go forward on that.

And then, also, on beverage, we also think there is a nice upside on beverage at Benihana, and not just only because of the offerings, but also because of the service style, and drinks don't really play a big role in that now. But I think over the next couple of months, we'll be putting more emphasis on beverage and on the bar, and I think that's actually going to be helping the average check as well as profitability for Benihana over the next year or two years.

Mark Smith

Perfect. I think the last one for me, and I apologize that I missed some of this. Of the, I think it's, eight to 11 new restaurants expected this year, can you just go through kind of the breakdown of those again? And then, any expectations on kind of near-term Q2, which of those openings maybe happen over the next couple of months?

Tyler Loy

Sure, Mark. This is Tyler. So, it's going to be one company-owned RA; it is one to two company-owned Benihana locations; one Salt Water Social in Denver; one to two Kona Grill; and then three to four STKs.

Manny Hilario

And the next one coming out the chute is going to be STK in Aventura, Florida. So that will be the next opening that we have. And then thereafter, we have Salt Water Social, and we have RA and we have a Kona Grill, all bunching in around the middle of the third quarter in terms of opening. And then, the rest is towards the end of third quarter, early fourth quarter.

Tyler Loy

And sorry, Mark, that was [indiscernible] two to three Kona Grill.

Manny Hilario

Yeah, two to three Kona Grill.

Mark Smith

Two to three, not one to two. Okay. Thank you.

Operator

Thank you. Your next question comes from Michael Symington, Wedbush. Michael, please go ahead.

Michael Symington

Hi. This is actually Michael on for Nick at Wedbush. Two for us, I guess, maybe just a modeling question to start. Could you provide the comp breakdown in Q1 for both STK and Kona?

Tyler Loy

Yeah. Give me one second. It was minus 6.8% for STK, Michael, and minus 9.7% for Kona Grill.

Manny Hilario

And then, traffic...

Michael Symington

Sorry, in terms of traffic and pricing embedded in that?

Tyler Loy

Yeah, I've got it. So, checks down at STK minus 4% and then average check was minus 2.5% and pricing in that average check was 4%. And then, for Kona Grill, traffic, minus 14%. Pricing -- our average check was plus 4.5%, with pricing up 7% in there.

Michael Symington

Great. Thanks. And then, you guys have talked about targeting 17% margins at Kona. Just wondering if you could provide an update on the margin profile you're seeing at the new units and how that really compares to the older legacy units that you talked about needing to potentially look at a little bit of work on.

Manny Hilario

I mean the prototype ones have done really well, the new ones. And the reason is I think labor has been better. I mean I'll just preface that by saying that they're still early on their life cycle. So their profitability will be improving there as well. But I would say the new stores have been on how we expected on the margin. I would say, in general, the Kona Grill brand, we do have core restaurants, which we kind of refer to, from the acquisition around 18 of the restaurants, have an average margin of about 13% plus. And then, we have about six Konas in there that. Frankly, the real estate is not what we would do today. So I think really, the margin fix with Kona Grill is to continue opening those new restaurants. I think the core ones are still in solid margins for the casual sector. And then we got to work out the plan for these other six restaurants and get them to a better place. So that's really how we're targeting that. But I'm pretty pleased with the progress on the new restaurants on the margin side.

Michael Symington

Great. Thanks very much. I'll hop back in the queue.

Operator

Thank you. Your next question comes from Roger Lipton, Lipton Financial. Roger, please go ahead.

Roger Lipton

Yes. Hi, Manny. Hi, Tyler. Congratulations on getting the deal completed so quickly. It seems like about five weeks from announcement to closing. So, the lawyers must have been busy. A couple of questions. It sounds like the synergies from the -- combining the companies is going to be in place pretty quickly. Can you give us some idea of where that's coming from? That run rate sounded like, by the end of this year, it will be pretty much in place. So that's the first question. Second question is, what does the current balance sheet look like post the closing in terms of cash and long-term debt?

Manny Hilario

Yeah. I mean, so I think the synergies, a lot of the initial ones which we are already working on our supply chain. So, I think that's going to be a really good area of synergies for us. We've already started looking at beef and integrating our supply chain because we have a lot of purchasing power on that side. And I think that's going to be significant for us. I think there's also some other efficiencies with rebates and some of the stuff in supply chain. So that will be level one, they'll be relatively enacted quickly. I think the outlook on just the operations, I think there's a lot of things that we can do in terms of -- for instance, we have a call center. I also think that we can have labor efficiency at the restaurants when we bring in our services to the call center. So that's looking pretty good.

Tyler Loy

And then, Roger, in terms of the balance sheet, in the previous IR presentation, we had said a little north of \$50 million there on the balance sheet. And then, debt after the transaction is going to be about \$350 million. So, net debt, we anticipate to be around \$300 million or so.

Roger Lipton

Okay. All right. Very good. Thanks very much. Go ahead.

Manny Hilario

Yeah. The only thing I would add to that is we also have a \$40 million revolver that we brought in with this new debt deal and no covenant. So, we have the credit -- the loan -- term loan is a no covenant term loan, and then we only have financial covenants if we draw over a certain amount on our revolver, which we have no plans to do it any time in the near future.

Roger Lipton

Thanks very much. Good work. Thank you.

Manny Hilario

Thank you, sir.

Operator

Thank you. There are no further questions at this time. Please proceed.

Manny Hilario

Thank you, everyone, for joining today. Again, thanks to our over 10,000 teammates who work hard -- very hard to -- every day to live our mission of creating great memories and doing that through executing great experiences, memorable experiences and exceptional experiences at the restaurants to every guest every time. So, thank you for that. And then, I look forward to seeing you all out in our restaurants. Everyone, have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your line.

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