

Kura Sushi (KRUS): A Bet On People

Eating Sushi

Kura checks nearly all our boxes for a potential investment:

- Competitive advantages
- Strong insider alignment
- Durable unit economics
- Long runway for growth
- Little debt

Let's get after it.

Business Description: Kura Sushi USA, Inc (KRUS). operates revolving sushi bar restaurants in the United States. The company's restaurants offer Japanese cuisine and a revolving sushi service model. It operates 24 restaurants in five states.

The Thesis: KRUS is a patent protected, technology-first sushi restaurant. The company offers high quality sushi at low prices thanks to robotic rice makers, automated dishwashers and a conveyor-belt delivery system. Such technology enables KRUS to offer lower prices while maintaining strong operating margins. KRUS flies under-the-radar of most investors IPOing around \$150M. [Its parent company](#) has over 30 years of success in Japan. **We think KRUS can grow into a 300-store empire generating \$50M in annual FCF.**

Unique Dining Experience: KRUS is [unlike any other sushi restaurant](#) in the US. The food comes to your booth via a conveyor belt. There's no waiters/waitresses to take your order. Everything's done at your booth via monitors. Diners also receive in-restaurant rewards like prizes for ordering 15 plates of sushi. There's also a mobile app to track your Kura rewards (\$5 coupon when you spend \$50, etc.). When you're done eating, simply deposit each plate into the installed plate disposal mechanism *at your table*. Each plate travels into an automated dishwashing system, removing the need for bus-boys and additional staff.

Technology-First Restaurant: We know about the conveyor belt, rice makers and automated dishwashing systems. But there's two other facets to KRUS technology that give it an edge. First, each plate of sushi has its own unique barcode. The dishwashing system scans the plate and records which type of sushi you ate. This data allows chefs/rice makers to optimize how much of each type of sushi to produce.

Second, KRUS has patented technology on Mr. Fresh, their conveyor belt sushi delivery system. Mr. Fresh is a dome that covers each plate of rotating sushi (the sushi you don't specifically order). Each dome has an embedded chip that alerts the kitchen when a customer takes the sushi. It also monitors how much time that plate has spent on the belt (keeping items fresh).

What's It Worth: There's a few main drivers to increase per-share value: **annual store growth, gross margin expansion and cap-ex % reduction.** Using its parent company as a proxy, steady-state KRUS would generate 40% gross margins, 5% operating margins and ~6% FCF margins. Assuming 20% annual store growth, we end 2024 with \$160M in revenue, \$64M in gross profit, \$8M in operating income and \$9M in FCF. Let's review what shareholder value would look like under three scenarios (**bold** = higher than current market cap):

	NOPAT Mult.			
# of Stores	7	8	9	10
300	\$216.38	\$247.30	\$278.21	\$309.12
150	\$108.19	\$123.65	\$139.10	\$154.56
100	\$92.70	\$105.94	\$119.18	\$132.43

We updated our thoughts on the company on 11/27, which you can read below ...

Mr. Market values KRUS at \$141M today (11/27). But what would their sales and income look like *if* they reached 300 stores? Luckily we can use their Japanese parent company as a proxy. Kura Sushi Japan does 40% gross margins, 5% operating margin and 6% FCF margin.

Now, the company generates ~\$2.57M/store in revenue (\$64M / 25 stores). If we assume they hold that average across 295 stores we get \$750M in revenues. And if KRUS operates like its parent company, they'll generate \$300M in gross profit, \$37.5M in operating income and \$45M in FCF.

In that reality the company looks **screaming** cheap (3.13x steady-state FCF & 0.18x sales).

The COVID Crisis: Can The Company Survive?

The above scenario looks great and all. But what about COVID? What about KRUS' main differentiating technology: **high tech conveyor belts.** California banned all conveyor belts amidst COVID. Will those ever come back?

We can't answer those questions with any degree of certainty. But what we can do is look at the balance sheet to see if the company has the liquidity to survive a lengthy compression.

At the end of the recent quarter KRUS had \$9M in cash with no long-term debt. However, they did have \$58M in capital lease obligations. Here's KRUS CEO Hajime "Jimmy" Uba's take on the company's liquidity situation from the latest earnings call (emphasis mine):

*"In terms of liquidity, I would like to reiterate how fortunate we are to have entered this challenging time with a **capital position that can sustain our company and our growth plans.** As of the end of the quarter, we had **\$9 million in cash on hand and no debt.** We have also **increased our revolving line of credit to \$35 million from Kura Sushi Japan, along with an extension of the payback period from 1 year to 5 years.**"*

Kura Sushi Japan is an incredible partner during this challenging time. The stronger, larger parent company provides KRUS with flexible credit terms and ample liquidity should KRUS need it.

The company started drawing down its credit facility for its planned 2021 Cap-ex program. Again this is a signal of strength, not weakness. KRUS isn't drawing down because they need cash to keep the lights on. Rather to expand and invest in new stores.

We should also note that the company continues to see increased demand for its sushi. Check out what's happening at KRUS' New Jersey location (emphasis mine):

*“We saw another example of this with our recent new restaurant opening in Fort Lee, New Jersey subsequent to the end of the quarter, **where sales levels have reached 50% to 60% of our pre-pandemic system AUV in spite of New Jersey's 25% seating capacity limitation.**”*

We're risking 100bps here and will add to it if the stock continues its breakout above its symmetrical triangle pattern.