Krispy kreme case analysis

Krispy Kreme doughnuts, Inc is facing a crisis of a drop in share price like never before since its initial public offering in the year 2000. The situation of Krispy Kreme does not look so bright after it has reacquire the underperforming franchisees' stores worth of 170$ million. In the end of 2004, the company has some problem related with its accounting for the acquisitions of certain franchisees that it has to restated its financial statement, which would lower the pretax income by 6 to 8 million.

The company fails to file the report on time. This puts the company at risk of being delisted out of NYSE, moreover there's a low carbohydrate diet trend coming. All those storms have put the company's share to sell at less than $10 a share. Therefore we recommended Krispy Kreme consider buying back its share Problem Statement After Krispy Kreme's share (KKD) reaching its peak in Aug, 2003, at nearly $50, only a year after that, KKD was trading only at $14 on the New York Stock Exchange.

Company stated that the breathtaking fall was the result of the impact from the diet trend in the US. However, the gospel truth was the poor performance in their expansion strategy and the aggressive reacquisition plan. But, the most unforgivable failure was to unable timely file its FY2004 financial report. As a result, KKD could constitute a default under their $150 million credit facility, and has lost nearly $2. 5 billion in its market value of equity.

A False Step in the Expansion Strategy Over one-fourth of revenue generated by Krispy Kreme had been tied to the growth in the number of franchised stores because in addition to the franchise fee and loyalty payments, the company also requires franchisees to buy equipment and ingredients from headquarters at marked-up prices. So, the company almost tripled its unit base since 2000 to 2004 (company factory store from 58 units to 141 units and franchised factory store from 86 units to 216 units).

However, too many stores were opened in poor location (E. . grocery stores and convenience stores). As a result Krispy Kreme saturated its own market too soon. So, what the company should do is to grow in a slower rate, take more time to survey the location and demand in a certain area in order to prevent mistake and failure. An increase in the international expansion is something the company should take into consideration as the matter of fact that the U. S. market is nearly becomes saturated.

The Aggressive Reacquisition Plan During 2003 there’re seven stores Michigan franchise that are underperformed and owed several millions for equipments, Krispy Kreme would like to close them therefore Krispy Kreme has reacquired $170 million of franchise rights (unamortized) and booked them as an intangible asset or goodwill, which makes the company’s balance sheet looks exaggerated. This result in a fall of the return of invested capital compared with the two years ago prior to the reacquisition from 18% to 10%.

To resolve this problem, the company should first try to improve the operation quality of the franchisees instead of buying back and raise the purchase price as compensation. The company should focus more on how the franchisees run their off-premises business. Krispy Kreme needs to emphasize on what was drive them here, “ Hot Doughnut Now” instead of the cold doughnut sale in a grocery stores and gas stations.

Assuming that the company repurchased the stores that are still in debt to them, not only that the company reduce its receivables but also it has decreased its cash as well. So instead of making unamortized reacquisition the company should amortize those reacquisition plans. The Ideal Time for Share’s Repurchase By August 2003, Fortune magazine was calling Krispy Kreme the " hottest brand in the America", and KKD was trading almost at $50.

But after the company failed to file its financial reports on the very beginning of the year 2005, KKD was trading less than $10. It seems to be the ideal time for share repurchase program, and this can also help to signal to the market that the stock is perceived as undervalued, so it can somehow boost up the demand of the stock. However, even though the company has only small amount of the excess cash but still the stock repurchase is way more attractive and right thing to do than repurchase underperforming franchisee’s stores.