Case 33 california pizza kitchen

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California Pizza Kitchen Summary California Pizza Kitchen is an upscale pizza parlor based out of California. It was founded in 1985 by defense attorneys Larry Flax and Rick Rosenfield in Beverly Hills, California. The company has 213 stores with approximately 41% of the stores located in California, 6 in foreign counties and the rest scattered throughout 27 other states in the U. S.

It derives its revenues from three different sources: sales at company owned restaurants, royalties from franchised restaurants, and royalties from its partnership with Kraft Foods in which they sell frozen pizzas in grocery stores under the California Pizza kitchen name. CPK also has developed a quick " grab and go" restaurant called ASAP which are located mainly in airports and malls. However, they have halted expansion of this in order to focus on international development of its main restaurant.

With the recent 10% share price decline, CPK management considers if it would be an ideal time to repurchase shares and potentially leverage the company's balance sheet with its existing line of credit. In order to continue to fund strong expansion, it is considering repurchasing shares and will need to use debt financing to pursue this. Since going public the company has avoided using debt to finance growth operations. Questions 1. To improve the company's performance they would need to restructure their capital policy and make use of the available leverage.

By using debt, they can repurchase their stock and continue to grow at a steady pace. It would also reduce the tax liability and increase ROE. Another way to improve CPK is to increase spending on advertising to expand brand

recognition. Currently only 1% is spent on advertising compared to other similar restaurants which spend 3% to 4%. 2. CPK currently has no debt on their balance sheet. Not only should they use debt leverage, they need an optimal amount that will increase their financial capabilities but not over-leverage so the cost of capital won't harm their financial performance.

A careful balance of leverage will help increase ROE as there are benefits from funding growth as well as reducing the amount of taxes to be paid. By increasing the amount of leverage, it would also decrease the Cost of Capital for CPK. More reliance on debt for funding would create a tax shield and therefore increase the profitability of the company compared to their current policy of no debt. 3. Under the various scenarios of 10%, 20%, and 30% Debt/Total capital the following calculated share price would result: Total Outstanding Shares: 29, 130, 000

Share Price| % Change From Actual| Actual: 22. 10| | 10%: 21. 58| (2. 4%)| 20%: 21. 05| (5%)| 30%20. 53| (7. 6%)| Note that these scenarios do not consider the repurchase of shares that was suggested. 4. The capital structure that I would recommend would be the 30% scenario. Here they maximize their tax shield advantage and, with the repurchase of stocks, can raise the share price to minimize the loss of the market value of the equity.