California pizza kitchen case study

Business

It is a casual dining, lull service restaurant concept that specializes in gourmet pizzas with unique topping combinations. They operated 213 locations in 28 states and 6 foreign countries by the end of the second quarter of 2007. Almost all of the firms revenue come from company-owned restaurants sales (98. 8%), with only 1. 2% coming from royalties generated by franchised restaurants and a partnership with Kraft Foods to sell CAP-branded frozen pizza in grocery stores (Burner, Decades & Chill, 2010).

Although the economy as a whole has been sluggish as consumers attempt to save none by eating at home, California Pizza Kitchen stands out from its competitors as it attempts to gain market share. Restaurant analysts have projected a five-year compound annual growth rate of 6. 5% for the restaurant industry as a whole (Burner, Decades & Chill, 2010). At the end of 2006, Cap's sales growth rate was 15. 6% while the average industry growth rate was 5%, meaning Cap's growth rate was approximately 10.

6% higher than industry average.

Despite strong growth, the company's share price declined 10% too value of $22. 10 due to economic issues as a whole. Due to he decline, Cap's management is considering buying back shares through a stock repurchase program as they feel the stock is undervalued at the current price. A look at Cap's balance sheet from the 1st quarter of 2007 shows cash, cash equivalents and other receivables make up only 5.

3% of total assets. With such a small amount of cash on hand, the company must use debt financing to fund the stock repurchase program.

Currently, the company has a 0% debt capital structure and must determine the optimal amount of debt to equity needed to fund the stock repurchase as well as other capital intensive endeavors and still remain profitable. Various other developments being tested by Cap's management are partnerships with ASAP restaurants, which are located in airports offering limited " grab-n-go' popular CAP menu items; strengthening partnership with Kraft Foods, which offer royalties of 95% of pretax margin and advanced marketing support; as well as a new concept, the LA Show, which offers a more upscale menu than CAP.

Implementation of these plans would require $85 million in additional capital, which would require CAP to acquire some amount of debt as there is not currently sufficient equity available. California Pizza Kitchen's current capital structure is O % debt, 0% preferred stock, and 100% equity.

Historically, the company has financed its operations through common stockholders and has chosen not to acquire any long-term debt. While this makes the company less risky for investors, some risk (debt) can actual be healthy for company and improve shareholder equity.

In the case of California Pizza Kitchen, obtaining debt should not be an issue as they already nave resources readily available to them in the form of a $75 million credit line. With this safety net in place, he business risk as a result of having no debt is conspired very low. However, financing a company completely on equity is quite costly compared to financing with debt, especially in a time when the cost of debt is low (6. 16%) compare with cost of equity (9.

5%).