

Initiating Coverage:

Krispy Kreme Inc.

A Sweet Partnership with a Known Brand Incoming

Key Take-away: Two massive food brands coming together to sell their product does not happen every day. The supposed mutualistic relationship should provide meaningful synergies to a fast food brand that desperately needed more outlets to sell its beloved product to its customers that often find themselves too far away from its doors.

McDonalds: In July of 2024, McDonalds and Krispy Kreme announced that starting in Q4 2024, Krispy Kreme would bring its Delivered Fresh Daily donuts to McDonalds Franchises to be sold as a dessert option, with a goal of reaching every McDonalds in the US by the end of 2026. We believe this has potential to be a gamechanger for a company with weak bottom margins. If executed, it will meet management's goals of expanded door opportunities at all costs, creating a runway for the EBIT% enhancement it targets.

Divestiture of Insomnia: As part of its core focus on the classic donuts, Krispy Kreme winded down its majority stake in Insomnia cookies, the college-town late-night cookies and ice cream business, down to a 34% stake in the business, with the stake sold to sponsors that will cooperate in management's goals in the company. However, it is implied that the two new sponsors, Mistral Equity and Verlinest Partners will take a more active role so that \$DNUT management can focus on their core system shift.

New Markets in Spain and Morocco: Krispy Kreme announced in August it found a partner, Americana Restaurants, for its joint venture in Morocco. This comes just days after its announcement of a similar JV in Spain. Management noted that they have regionally inspired flavors developed, like the caramel, cinnamon, and "lemon dream" donut and 100% arabica coffee in the works for the Moroccan stores. This comes after successful launches in more traditional Western markets like France, whose opening was picked up by a headline NYT piece. Still, numbers must come in to certify these JVs as successes.

Valuation: We initiate coverage with a \$11.50 PT.



Consortium Equity Research
Consumer | Food & Beverage
December 4th, 2024

Stock Rating: Overweight

Price Target: \$11.50

Price: \$10.89

Potential Upside/Downside: 5.6%

Ticker(s): \$DNUT

Market Cap: \$1.85b

Shares Outstanding: 170mm

Free Float (%): 51.54%

Dividend Yield: 1.29%

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Peer Comparisons

Comparable Companies

\$mm

Ticker	Mkt Cap	EV	P/E LTM	Revenue LTM	EBITDA LTM
Jack in the Box Inc. (NasdaqGS:JACK)	\$ 895	\$ 4,054	-25.3x	\$ 1,595	\$ 314
The Wendy's Company (NasdaqGS:WEN)	\$ 3,971	\$ 7,610	19.9x	\$ 2,197	\$ 512
Shake Shack Inc. (NYSE:SHAK)	\$ 4,416	\$ 4,935	175.2x	\$ 1,170	\$ 120
Texas Roadhouse, Inc. (NasdaqGS:TXRH)	\$ 12,494	\$ 13,122	32.2x	\$ 5,100	\$ 632
Krispy Kreme	\$ 1,954	\$ 3,483	-37.2x	\$ 1,740	\$ 159

Ticker	LTM EV/EBITDA	Gross Margin	EBITDA Margin	EBIT Margin	1 Yr Rev Growth Rate LF
Jack in the Box Inc. (NasdaqGS:JACK)	12.9x	29.8%	19.7%	15.6%	(7.4%)
The Wendy's Company (NasdaqGS:WEN)	14.9x	35.3%	23.3%	16.9%	1.7%
Shake Shack Inc. (NYSE:SHAK)	41.1x	37.4%	10.3%	1.8%	18.0%
Texas Roadhouse, Inc. (NasdaqGS:TXRH)	20.7x	17.8%	12.4%	9.1%	13.9%
Krispy Kreme	21.9x	28.5%	9.1%	1.3%	8.1%

High	41.06x	37.4%	23.3%	16.9%	18.0%
75th Percentile	21.95x	35.3%	19.7%	15.6%	13.9%
Average	22.30x	29.8%	15.0%	8.9%	6.8%
Median	20.75x	29.8%	12.4%	9.1%	8.1%
25th Percentile	14.85x	28.5%	10.3%	1.8%	1.7%
Low	12.90x	17.8%	9.1%	1.3%	-7.4%

Krispy Kreme Valuation

Implied Enterprise Value (25th Percentile)	\$	2,357
Implied Enterprise Value (Median)	\$	3,293
Implied Enterprise Value (75th Percentile)	\$	3,483
Implied Share Price (25th Percentile)	\$	5.44
Implied Share Price (Median)	\$	10.95
Implied Share Price (75th Percentile)	\$	12.07

Source: (CapIQ)

Company Overview

Utilizing its historic brand: The now 87 year old company still maintains its original yeast-dough recipe in its highly recognizable donuts for anyone who grew up in its main areas of operations, most predominant across the American South. The potential moat for Krispy Kreme would be the nostalgia factor associated with its donuts, especially its airy tendency, which gives it a nature different from many artisanal donut offerings. All its donuts sold are part of its trademarked Delivered Fresh Daily™, which it believes distinguishes itself from many of its large name brand baked-good offerings.

Transition to Hub and Spoke Model: Following a take-private in 2016, Krispy Kreme shifted its assets to reposition itself into a hub and spoke model. It's doughnut factories and theater stores would be utilized to produce donuts that could be delivered Delivered Fresh Daily™ to a dedicated network of smaller Krispy Kreme stores and other associated grocery and drug stores, which the company model calls "doors". It also sells D2C via typical ecommerce apps like Uber Eats. The strategy envisioned by management sought to more effectively utilize the capital intensive nature of donut frying and enjoy a higher system wide ROIC than any standalone franchise could. As a result, significant capital was invested to buy back franchised locations.

Further detail on the McDonalds Deal: McDonald's, with its ~14,400 US locations, fit DNUT's goal of increasing its "spokes per hub" KPI, which it sees as key to margin enhancement. Over the past year, the partnership tested the rollout in Kentucky, and were pleased with the results, leading to the announcement to make it a nationwide partnership. Both parties' management have been generally quiet on the revenue split and the exit contract terms. The benefit to Krispy Kreme is clear in that it satisfies its KPI growth, and McDonald's benefit is a new dessert offering to what is otherwise seen as a weak spot on its menu board. Management expects donuts in 1,000 McDonalds by the end of 2024, 6,000 by the end of 2025, and ~80% of US McDonalds by the end of 2026.

Industry Overview

GLP-1 Headwind Just the Latest: In the food industry, no trend is ever present. Every decade/era has seen its macro and micronutrients that have been either the darling child or been admonished. With GLP-1 usage among the public rising to ~6% in the US, with 12% having at least tried them once, companies are looking to cater towards what these consumers want. Further research will be done on what users on drugs like Ozempic, Wegovy, and Mounjaro crave, but preliminary results suggest that users prefer a greater emphasis on protein and low calorie options, and a lesser desire for sweets and high carbohydrate foods.

Is Flavor Back?: One of the lesser consequences of the COVID pandemic was the impact on infected people's taste buds. With so much restaurant food having to go through the delivery process, consumers had to experience a step back in the longer-term trend of humanity that sees gastronomy improve over time. Since recovery, we have seen the traditional development of cuisine innovating to appeal to flavor, whether that be through branding collaboration, fusion inspiration from traditional cuisines, or incorporation of more than just the sweet taste bud.

Desire for Value: Inflation grabbed the headlines of 2022 & 2023. The headlines for 2024 have been on the value that many food & beverages companies have started to offer in the wake of a clearly ailing consumer. Real income declined narrowly across a couple of quarters in 2022 & 2023, and with food & beverage, and in particular fast food having seen some of the largest price increases, franchises were more than happy to trade some margin dollars for revenue dollars if the volume gained would be sufficient. Dominos, Wendy's, McDonalds, and Subway are just a few to name that put a strong effort to promote either their value deals, reduced prices, or larger portions. Fast casual restaurants that perform better in the calorie/dollar metric have also outperformed, mirroring their fast food counterparts.

Investment Theses

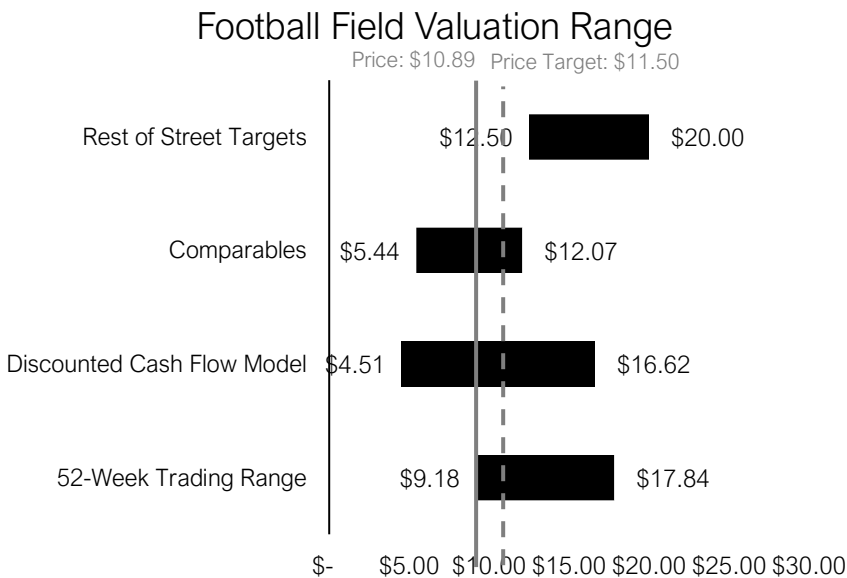
Unit Economics: The increased spokes per hub will enhance unit economics, as donut manufacturing by nature has a decreasing marginal cost. Given the fixed investment \$DNUT has made and the employees it already retains, new donuts made for new spokes will bring significant margin dollars into the business, rising overall margins. We expect a near tripling from the current 8,000 doors to roughly 23,000 doors by 2026. Equally we expect ~90 spokes/hub by 2026, up significantly from the 38 spokes/hub we see today.

Balance Sheet Rejuvenation: If the business model transition, with its renewed focus on the spokes per hub KPI is successful, there will be a strong opportunity for capital allocation towards balance sheet strengthening. With an expected free cash flow margin of 13.7% by 2026, the company will be able to delever to an expected 2.5x net leverage by 2027.

International Expansion: Krispy Kreme’s growth prospects will not be limited by the completion of the hub and spoke model in the US. Early returns show that foreign markets are promising for the company, with the US model under implementation coming from the Australian JV’s approach years back. The potential countries to be expanded to ensure TAM unlock for a growth story to remain behind Krispy Kreme for years to come.

Price Target & Valuation

Our analysis gives \$DNUT a price target of \$11.50 and an overweight rating.



Our Price Target: **\$11.50**

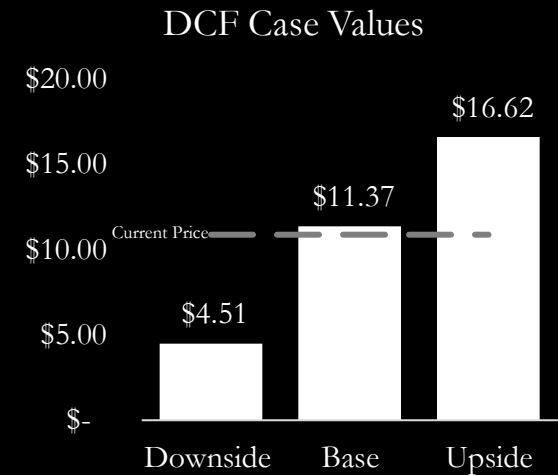
Our PT is based on the assumption that the process of adding spokes to hubs is successful with relatively few bumps, most hubs are able to DFD to doors, and demand remains strong and grows roughly with food expenditures

Our Upside Case: **\$16.50**

Our upside case assumes that the widespread availability of donuts launches Krispy Kreme to a nation-wide brand and one of the most popular sweet treats in the country. Additionally, investor hype grows around the blue-chip nature of the brand and its consistent recipe as a company that is a known executor.

Our Downside Case: **\$4.50**

Our downside case is that there are several hiccups with hubs responding to the newly manufactured demand, and deliveries struggle to reach doors, quality of the donuts deteriorate as Delivered Fresh Daily becomes a handcuff that massacres logistics and doesn’t meaningfully improve quality.



Potential Downsides to Our Rating

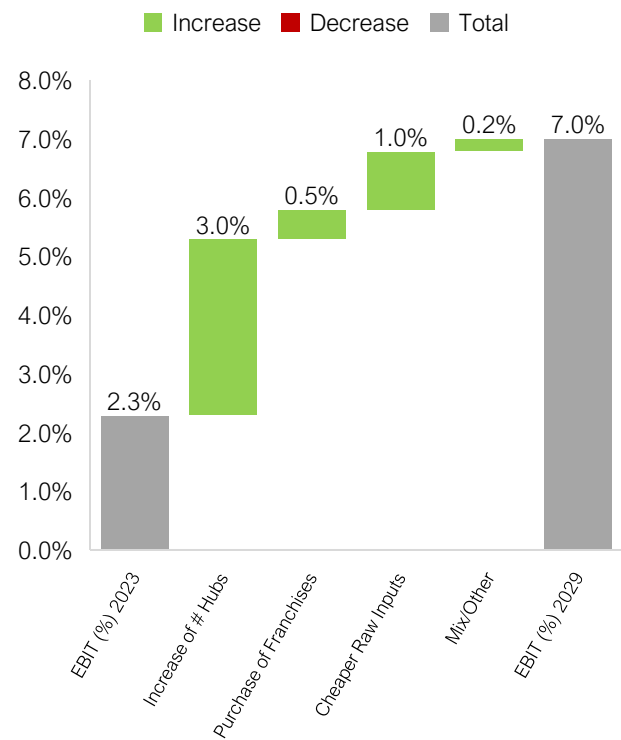
Demand Saturation: Krispy Kreme’s push to expand doors during its prior stint as a publicly traded company soured when sales became stagnant in the late 2000s-early 2010s. The hub and spoke model and current focus of management is highly dependent on the continued desire for donuts, even when the scarcity effect that enshrouds the business today subsides. Should sales slip, the bottom line for Krispy Kreme could be uniquely hurt given its high operating leverage relative to much of the food service space.

GLP-1s: Closely related to the potential of demand saturation is the possibility that Krispy Kreme loses a large segment of its customer base to those on novel weight loss drugs like Wegovy and Mounjaro. Studies show that those on the drugs have a lessened tendency for high calorie foods, and especially lose their appetite for sweet goods and baked goods. If preliminary results are true, that could spell trouble for the business if enough of the population starts taking shots.

General Execution Risk: There is a lot being asked for local managers within the Krispy Kreme business to be able to reliably deliver to all of its spokes, including all of the McDonalds within a hub’s given area, while still ensuring the donuts are fresh and desirable. If customers start sharing reviews that donuts received at a McDonalds or any other door for that matter are stale or bland, that would deal a serious blow to the marketing campaign of Delivered Fresh Daily.

Projections

EBIT Waterfall Chart



Income Statement (\$mm)	2023A	2024E	2025E	2026E	2027E	CAGR%
Revenue	1,384	1,580	1,727	1,884	2,049	10.3%
EBITDA	128	130	155	183	215	13.8%
EBIT	32	30	50	74	102	33.8%
EBIAT	26	(5)	25	30	36	8.6%

Margin & Growth Data	2023A	2024E	2025E	2026E	2027E	AVG%
EBITDA Margin	9.3%	8.2%	9.0%	9.7%	10.5%	9.3%
EBIT Margin	2.3%	1.9%	2.9%	3.9%	5.0%	3.2%
Revenue Growth	-9.5%	14.1%	9.3%	9.1%	8.8%	6.4%
EBIT Growth	2.8%	-5.4%	68.1%	47.2%	37.0%	29.9%

Valuation Metrics	2023A	2024E	2025E	2026E	2027E	AVG%
P/FCF	-24.8x	-41.1x	7.8x	8.7x	10.4x	-7.8x
EV/Sales	2.4x	2.1x	1.9x	1.7x	1.6x	1.9x
EV/EBITDA	34.1x	32.9x	31.4x	30.1x	29.0x	31.5x
FCF Yield	-4.0%	-2.4%	12.9%	11.4%	9.6%	5.5%

About \$DNUT

Krispy Kreme, Inc. (\$DNUT), founded in 1937 and headquartered in Charlotte, North Carolina, operates as a global retailer and wholesaler of premium doughnuts and sweet treats. The company operates in over 30 countries through a combination of company-owned stores, franchise partnerships, and omnichannel distribution, including retail grocery and e-commerce. Its business is segmented into Krispy Kreme U.S. & Canada, International, and Insomnia Cookies, focusing on direct-to-consumer and branded sweet treat experiences. Krispy Kreme's key purpose is to deliver moments of joy through its iconic products while expanding its global presence and leveraging its "hub-and-spoke" production model for enhanced efficiency and scalability.

Disclosures & Ratings

Consortium Equity Research does not hold any professional relationships with any reported equities. **Overweight** means the analyst team believes the stock price will outperform the coverage industry (TMT, Healthcare, Industrial, Consumer, FIG, Energy & Sustainability) in the next 6-12 months. **Equal Weight** means the team expects performance in line with the industry. **Underweight** means the team expects underperformance relative to the industry.

Appendix

Krispy Kreme
Discounted Cash Flow

Active Case:	2 Base
Current Share Price	\$10.89

DCF Analysis (\$mm)											
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029
	12/31/19	12/31/20	12/31/21	12/31/22	12/31/23	12/31/24	12/31/25	12/31/26	12/31/27	12/31/28	12/31/29
Stub						0.07	0.07	0.07	0.07	0.07	0.07
Discount Period						0.04	0.57	1.57	2.57	3.57	4.57
Revenue	0.00	0.00	1,686.10	1,529.90	1,384.39	1,580.00	1,727.27	1,883.68	2,049.17	2,223.57	2,406.65
Revenue Growth	0%	#DIV/0!	#DIV/0!	-9%	-10%	14%	9%	9%	9%	9%	8%
Revenue Breakdown 1	0.00	0.00	1,592.57	1,443.26	1,305.60	1,500.00	1,645.50	1,800.18	1,963.99	2,136.82	2,318.45
Revenue Breakdown 2	0.00	0.00	58.59	54.62	47.87	50.00	52.25	54.34	56.24	57.93	59.38
Other Revenue	0.00	0.00	34.94	32.02	30.93	30.00	29.52	29.17	28.93	28.82	28.82
EBIT	38.50	3.88	35.33	30.83	31.70	30.00	50.42	74.20	101.63	132.96	168.47
EBIT Margin	#DIV/0!	#DIV/0!	2%	2%	2%	2%	3%	4%	5%	6%	7%
Tax Expense	12.58	9.11	10.75	0.61	(4.30)	10.00	10.59	15.58	21.34	27.92	35.38
Effective Tax Rate	33%	235%	30%	2%	-14%	33%	21%	21%	21%	21%	21%
NOPAT	25.92	(5.23)	24.58	30.21	36.00	20.00	39.83	58.62	80.29	105.04	133.09
D&A	42.47	54.10	71.81	81.76	96.49	100.00	104.73	109.21	113.35	117.09	120.33
Capex	76.40	97.80	119.50	111.70	121.40	150.00	(110.46)	(62.09)	(4.06)	64.51	144.40
Changes in NWC	0.00	(67.10)	(37.30)	14.76	10.79	15.00	16.57	18.26	20.08	22.01	24.07
UFCF	(50.48)	(170.13)	(132.22)	(66.73)	(74.61)	(45.00)	238.45	211.65	177.61	135.61	84.95
PV of FCF						(44.90)	230.19	192.15	151.64	108.89	64.15

Weighted Average Cost of Capital (\$mm)	
Market Risk Premium	4.24%
Beta	1.34
Risk Free Rate	4.22%
Cost of Equity	4.95%
Weighted Average Cost of Debt	3.50%
Tax Rate	21.00%
Cost of Debt	1.38%
Total Equity	\$1,851
Total Debt	\$1,435
Equity/Total Capitalization	50.00%
Debt/Total Capitalization	50.00%
WACC	6.33%

Terminal Value	
Perpetuity Growth Method	
2029 FCF	\$85
Growth	0.00%
Terminal Value	\$
PV of Terminal Value	1013.083701
PV of Projection Period	\$702
PV of Terminal Value	\$1,013
Implied TEV	\$1,715
(-) Debt	\$1,464
(+) Cash	\$25
Implied Equity Value	\$255
Basic Shares Outstanding	173
Implied Share Price	1.64714122
Upside/Downside	-85%
Implied BV EV/EBIT	57.17

Terminal Value	
Exit Multiple Method	
2029 EBITDA	\$269
EV/EBITDA Exit Multiple	13x
Terminal Value	\$3,754
PV of Terminal Value	2835.098977
PV of Projection Period	\$702
PV of Terminal Value	\$2,835
Implied TEV	\$3,537
(-) Debt	\$1,464
(+) Cash	\$25
Implied Equity Value	\$2,102
Diluted Shares Outstanding	173
Implied Share Price	\$12.35
Upside/Downside	14%
Implied PGR	-2%

Blended Share Price	
Perpetuity Growth Method	0%
Exit Multiple Method	100%
Blended Share Price	\$12.35
Upside/Downside	14%