



# Krispy Kreme Turnaround Strategy

## Strategy Coursework

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# 1 Introduction

In 2003 Krispy Kreme was named by Fortune Magazine as ‘America’s Hottest Brand’ and in 2004 they reported net income of \$50 million. However over-expansion, an expensive store network, revelations of falsified financial reports and changing trends in diet have meant that Krispy Kreme revenues have declined by 50% between 2005 and 2010<sup>1</sup>.

The strategic problem considered is to analyse Krispy Kreme’s current operations and suggest recommendations for how this may be tailored for the UK market for long-term profitability given cultural and retail differences.

## 2 Current strategy

Krispy Kreme operates 582 stores (including franchised) in 18 countries worldwide. Stores range from 4,000 to 8,000 square feet and are generally located in freestanding suburban locations. They also operate smaller satellite stores, kiosks and sell directly through large retailers such as Tesco.

Krispy Kreme is a vertically integrated business. Starting with their secret recipe, they make fresh doughnut mix each day, which is distributed to all stores. They manufacture their own doughnut and coffee machinery. Doughnuts are freshly made; they have a simple product line focused on doughnut variations and their own branded coffee (developed from the acquisition of Digital Java in 2001).

In the UK Krispy Kreme operates a subsidiary (with a 34% equity interest) with an exclusive development licence to the franchise in the UK.

## 3 External Analysis

### 3.1 Industry definition

Krispy Kreme state they compete in the quick service restaurant (QSR) industry. Our opinion (based on analyst reports and competitive analysis) is that they compete in the specialist eateries industry sub-segment of QSR.

The specialist eateries industry comprises companies that own, operate, and/or franchise **limited menu** eateries, including coffee houses and bagel shops.

### 3.2 PEST analysis

#### 3.2.1 Political

Political factors affecting the specialist eateries industry are few and consist mainly of minimum wage and employment law changes. Krispy Kreme train their staff who usually

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<sup>1</sup> See Appendix I

have little experience or education; consequently, they pay employees minimum wage or similar and are therefore affected by minimum wage increases.

Other political factors are government actions to reduce obesity; however it is very unlikely that government will legislate against high fat and unhealthy foods<sup>2</sup>.

### 3.2.2 Economic

The continued economic downturn has meant tightened consumer spending, as Krispy Kreme is a non-essential food item this may pressure sales. Inflation is above the Bank of England target and there is upward pressure on long-term interest rates as shown by the UK treasury yield curve. An increase in interest rates will increase the cost of capital and mean more expensive borrowing at a time that they could need to expand to compete with rivals.

### 3.2.3 Social

UK consumers are becoming more aware about the ingredients in food, e.g. boycotting trans fats, battery farmed poultry and mass farmed tuna. In 2008 this motivated Krispy Kreme to remove trans fats from their products. Low carb diet trends (e.g. Atkin's) can also have an effect on purchasing.

Going out to eat and drink is a social habit that is unlikely to change in the near future, but consumers can change their habits from eating doughnuts to other sweet foods such as ice-cream or pastries.

### 3.2.4 Technological

Due to the nature of purchasing and preparing foods, few technological trends influence the industry. However technology can be used to improve efficiency, production, distribution, and monitor commodity prices in real-time. Some commentators argue that ecommerce will erode visits to physical stores, however the convenience food nature of speciality eateries require strong physical presence to capitalise impulse purchases.

### 3.2.5 Environmental

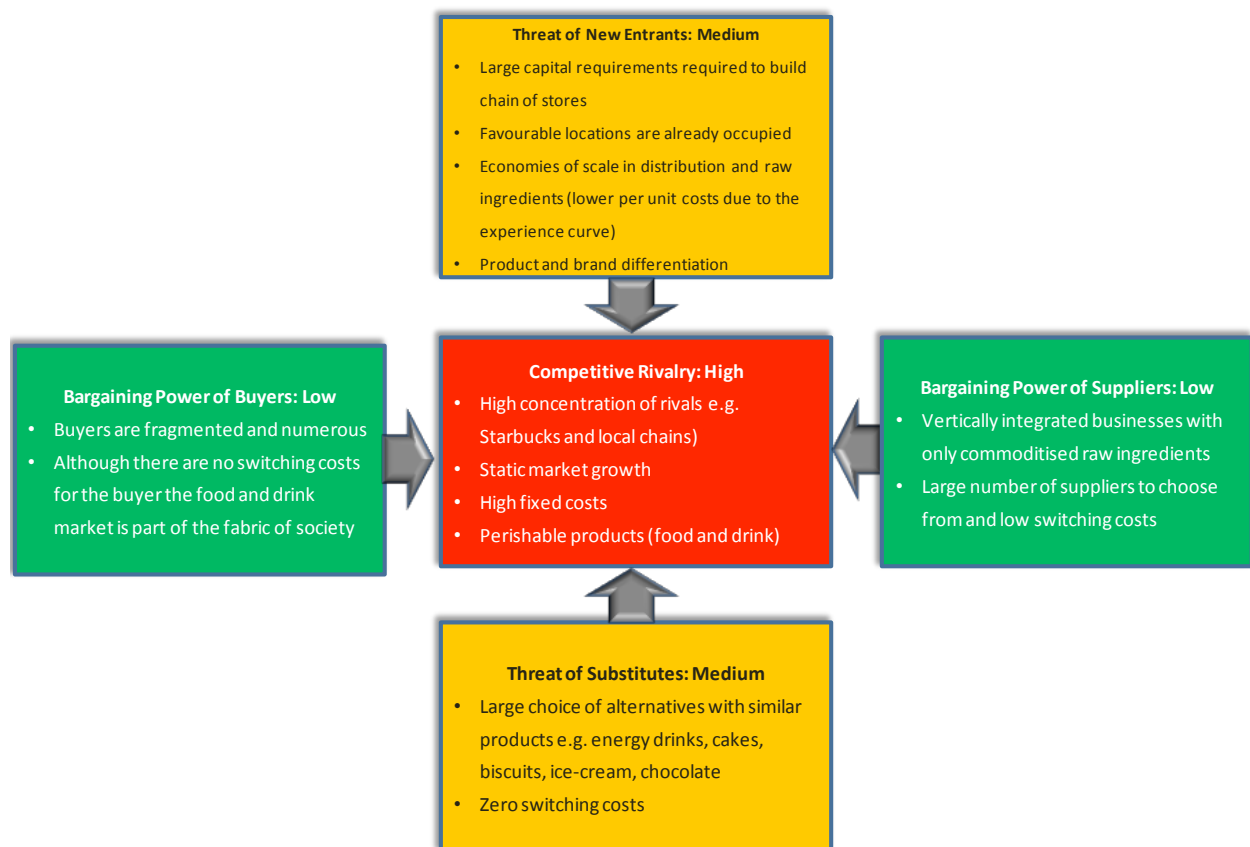
Fluctuations in commodity prices affect margins, as in 2009 when the price of wheat and soybean oil (key ingredients of doughnuts) reached record highs.

## 3.3 Industry five forces

Analysis of Porter's five forces has shown that the most important force in the industry is rivalry between competitors.

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<sup>2</sup> See section 3.2.3



**Figure 1 Porter's Five Forces: Industry Analysis of Quick Service Restaurants (QSR)**

### 3.3.1 Rivalry among existing competitors (High +++):

- High concentration of rivals e.g. Starbucks and local chains
- Static market growth
- High fixed costs
- Perishable products (food and drink)

A large number of competitors in the industry are all competing for the same customers. Coffee chains (e.g. Costa, Starbucks) are all competing to be number one in the market and have similar corporate goals.

While product differentiation is limited, there is fierce differentiation by product range, brand and store ambience (e.g. seating). There are zero switching costs for customers, which promotes price wars.

Market growth is static, which promotes fierce fighting for market share, and there is saturation of competition due to the limited number of prime locations available for outlets. Smaller chains have to pay a premium for prime sites or settle for less desirable locations.

### 3.3.2 Threat of new entrants (Medium +):

- Large capital requirements required to build chain of stores
- Favourable locations are already occupied
- Economies of scale in distribution and raw ingredients (lower per unit costs due to the experience curve)
- Product and brand differentiation

Capital requirements for individual stores are low, however new entrants wishing to compete on a like basis with national store networks, distribution channels, brand equity development and advertising, face large capital requirements to gain market share. This is reflected in the large number of individual outlets compared with the small number of large, proven top specialty eateries.

The UK commercial property market is landlord-driven and controlled; premium locations in the UK are scarce and command high prices with most of the favourable locations within town centres, airports and train stations already being occupied by existing competitors.

### 3.3.3 Threat of substitutes (Medium +)

- Large choice of alternatives with similar products e.g. energy drinks, cakes, biscuits, ice-cream, chocolate
- No switching costs

Although a consumer can choose from multiple substitutes (e.g. desserts, pastries or drinks), speciality eateries compete based on convenience and opportunity. Most people buy from speciality eateries when travelling, shopping or meeting people. This is evidenced by the location of the eateries, which is concentrated around high footfall locations such as train stations, business districts and shopping centres. For a consumer this becomes a competitive choice rather than a substitute choice (e.g. do I buy a coffee from Starbucks or Costa).

Other substitutes come from full menu eateries such as restaurants and fast-food outlets with a smaller threat from supermarkets.

### 3.3.4 Bargaining power of suppliers (Low):

- Vertically integrated businesses with only commoditised raw ingredients
- Large number of suppliers to choose from and low switching costs

### 3.3.5 Bargaining power of buyers (Low):

- Buyers are fragmented and numerous
- Although there are no switching costs for the buyer the food and drink market is part of the fabric of society

## 3.4 Competition analysis

### 3.4.1 Competition Identification

Krispy Kreme operates within the specialty eatery industry; however they compete with every outlet that a consumer can access in order to satisfy their need for coffee, snacks or treat-based items. These outlets include other specialty eateries, fast food restaurants, local convenience stores, and other retail environments that stock coffee and other beverages.

In relation to their core product (doughnuts), Krispy Kreme also has to compete with generic unbranded doughnut makers that are sold via doughnut vans and supermarkets. They

have no direct, like-for-like UK competitor in terms of product synergy (Dunkin Donuts entered the UK market in 1999 and have since withdrawn).

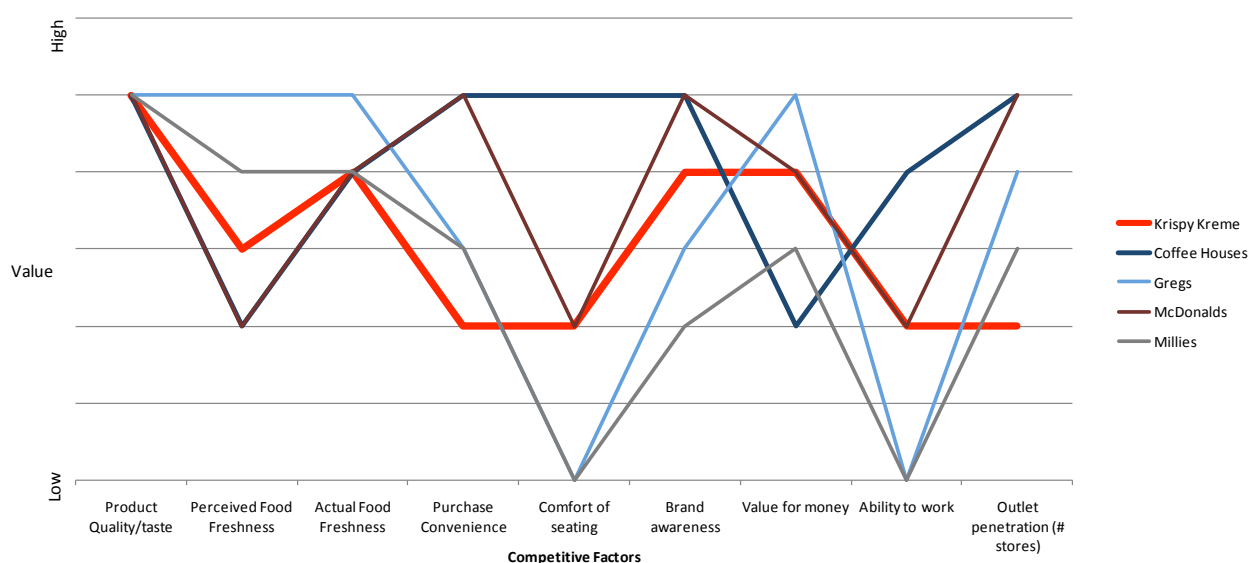
Based upon our analysis<sup>3</sup>, Krispy Kreme's competition have been identified as:

- Starbucks
- Costa coffee
- Café Nero
- Greggs
- Millies Cookies
- McDonalds
- Pret-a-manger
- Coffee Republic
- Café Ritazza

Whilst this appears quite broad, a customer is just as likely be fulfilled by an apple pie, at McDonalds, pastries from Greggs or cakes from coffee shops such as Starbucks, as they are through buying doughnuts and coffee at Krispy Kreme. In reality all of these firms are competitors.

### 3.4.2 Value Curve

External factors of competition perceived or valued by customers are illustrated in the Value Curve<sup>4</sup> below.

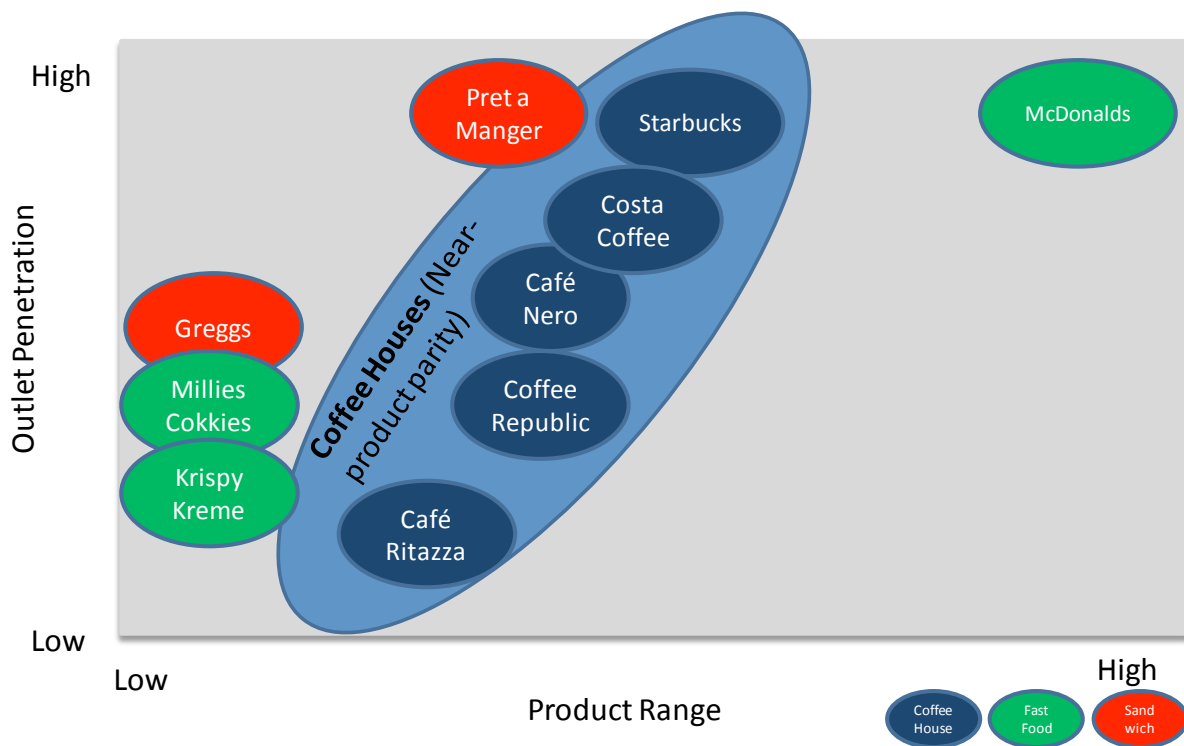


This demonstrates the challenges that Krispy Kreme face in differentiating themselves from their competition.

### 3.4.3 Strategic Groups

<sup>3</sup> Appendix A illustrates the analysis carried out in order to determine Krispy Kreme's UK competition. It was generated via a scoring system based upon factors such as types of products offered and competitors' operating models.

<sup>4</sup> The data behind the value curve is expanded upon in Appendix G.



Strategic Groups analysis shows Krispy Kreme is in a weak position compared with Starbucks, McDonalds and Costa Coffee. These companies have a much larger number of prime location outlets, offers a range of products that competes with Krispy Kreme, and offers more variety. Albeit, Krispy Kreme's claimed key differentiator is their product quality uniqueness as evidenced in by the Value Chain<sup>5</sup> and Value Curve<sup>6</sup> analysis:

Based on the criteria and axis analysed it is suggested that Krispy Kreme would need a much larger number of stores and potentially an increased product range beyond doughnuts and coffee in order to lead the industry.

#### 3.4.4 Brand awareness

To measure actual brand awareness, a sample population were surveyed<sup>7</sup>. Key results were:

- Krispy Kreme is relatively well recognised in the UK in comparison to its size. In addition Superbrands ranks Krispy Kreme as the 68<sup>th</sup> strongest brand in the UK only one place below Starbucks.
- Krispy Kreme doughnuts are not consumed on a regular basis.
- Krispy Kreme doughnuts were often consumed as part of a celebration or special occasion (e.g. birthday in the office) and were rarely purchased individually.
- One of Krispy Kreme's key stated differentiator, freshly made doughnuts, was not recognised by consumers.

<sup>5</sup> Section 3.4.2

<sup>6</sup> Section 4.1

<sup>7</sup> As detailed in [Appendix B](#)



Krispy Kreme had, until recently, had not used above-the-line advertising; instead relying on point of sale, PR and digital activity for promotion and brand awareness. Their first above the line advertising in September 2010 targeted the business market where it is already a popular choice for meetings, clients, and special events.

### 3.4.5 Further research

Interviews with Krispy Kreme staff<sup>8</sup> demonstrated that within the UK, doughnut theatre<sup>9</sup> is rarely used. Glazing machines may exist at some stores but even here in reality, pre-prepared doughnuts arrive each day from a regional distribution centre. The store simply displays and sells the items.

All drinks and coffees are prepared within the store, in line with Krispy Kreme's coffee shop competition.

## 4 Analysis of internal environment

### 4.1 Internal value chain<sup>10</sup>

As a vertically integrated business Krispy Kreme operates downstream and upstream in the value chain. Using Porter's value chain<sup>11</sup> we can show that Krispy Kreme's key value-creating activities are:

#### 4.1.1 Unique taste using secret recipe

The secret recipe from the 1930s gives Krispy Kreme doughnuts their unique taste. Krispy Kreme design and manufacture proprietary processing and doughnut making equipment and use only premium ingredients to ensure the consistency and quality of their product.

#### 4.1.2 Doughnut theatre experience

Doughnut Theater®, in stores produces a multi-sensory customer experience and establishes brand identity. The goal is to provide customers with an entertainment experience and to reinforce the commitment to quality and freshness by allowing them to see doughnuts being made.

#### 4.1.3 Cult brand Sharing ethos

Krispy Kreme doughnuts are a popular choice for sharing with friends, family and co-workers, which is very different to other competitors in the industry. Consumer research<sup>12</sup>

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<sup>8</sup> See Appendix C

<sup>9</sup> As detailed in section 4.1.2

<sup>10</sup> Data for the internal environment is based on literature generated by Krispy Kreme themselves, such as their annual report.

<sup>11</sup> See [Appendix A](#)

<sup>12</sup> Quoted in Krispy Kreme's annual report

has shown that the strength of the brand in shared-use occasions transcends international border and is reflected by the fact that:

- 60% of transactions are for 12 doughnuts or more
- 75% of purchases at domestic shops are for sharing occasions

The sharing concept is an integral part of marketing and is further enhanced by product packaging and volume price discounts. These high unit volumes per order mean Krispy Kreme have a high transaction value per customer compared to competitors.

#### 4.1.4 Cult brand with strong awareness

Krispy Kreme's cult brand means that stores have been built on word-of-mouth and local PR campaigns instead of advertising. New store openings are typified by huge queues and excitement with the community where the new store is located.

#### 4.1.5 Global network of stores and franchises

Krispy Kreme has the knowledge and expertise to operate a global network of stores and franchises; opening, operating, training and building stores across the world.

#### 4.1.6 Analysis of resources and capabilities

Only valuable, rare and hard-to-imitate resources and capabilities can potentially lead to sustained competitive advantage. The only value-creating activity listed above that does not meet these criteria is the store network, as it is neither valuable nor rare.

## 4.2 Financial analysis

### 4.2.1 Financial overview<sup>13</sup>

	<i>Krispy Kreme</i>	<i>Starbucks (market leader)</i>
Revenue	\$346.52m	\$10,707.40m
Operating Profit	\$(0.16)m	\$945.60 m
Return on Equity	7.14%	28.14%
Market Capitalisation	\$190.23m	\$18,935.10 m
Cash	\$20.22m	\$1,164.00m
Long-term debt	\$64.84m	\$549.40 m
Credit rating	B-	A-2

### 4.2.2 Store capital costs

In the USA typical stores cost an average \$1.8 million to build (not including the land), making it cost prohibitive to establish enough of them to achieve significant market penetration, without significant access to capital.

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<sup>13</sup> Revenues have been in slow decline since 2005. See Appendix I.

It should be noted however that in the UK the commercial property market is landlord-led.

#### 4.2.3 Credit rating and debt position

In order to compete with the market leaders and expand its store network Krispy Kreme needs access to around £284m<sup>14</sup>; with only \$20m cash in reserve it would need to raise debt to finance the growth. S&P rates Krispy Kreme as credit rating B- (junk bond category). This means that Krispy Kreme will find it harder and more expensive to raise debt.

## 5 Key themes from analysis

- Key industry factor is the intense rivalry between companies.
- To compete with the industry leaders large capital investment is required to increase the number of stores.
- Low cash reserves and limited access to debt means expanding the store network will be difficult and cost prohibitive.
- Strong brand awareness in the UK.
- The internal perception of Krispy Kreme of core values and differentiators such as Doughnut theatre and freshly made are not recognised by UK consumers.
- Large format stores mean higher fixed costs and lower profits as they lack volumes.
- Filing for bankruptcy and financial problems may have an effect on new franchise opportunities.
- A social trend towards healthier food.
- Sharing concept is an integral part of the brand with consumer survey showing that 75% of transactions being bought for sharing purposes.
- No like for like competitor in the UK.

## 6 Recommendations

Based on our analysis we propose that the limiting factor for growth and profitability is building and running the physical network of stores and the intense rivalry in the industry.

To increase profitability in the UK we have three strategic recommendations.

	<i>Urgency</i>	<i>Importance</i>	<i>Complexity</i>	<i>By when</i>
<b>Abandon large format stores and sell via mobile kiosks via third party retailers</b>	High	High	High	Q4 2011
<b>Develop new distribution capabilities</b>	High	High	Medium	Q2 2011
<b>Sell direct online targeting businesses</b>	Medium	High	Low	Q1 2011

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<sup>14</sup> See Appendix F

## 6.1 Abandon large format stores and sell via third party retailers using mobile kiosks

We suggest removing the existing store network and placing mobile kiosks in third-party store networks such as Starbucks. Krispy Kreme has already tested this strategy with Tesco and Moto<sup>15</sup> where they have unmanned kiosks (cabinets) and customers collect their own doughnuts and pay at the retailers till. Each kiosk is stocked between once and twice per day with fresh doughnuts.

By using this strategy existing potential competitors could become potential customers. Assuming agreements could be reached, Starbucks, Café Nero and other outlets could use the mobile kiosks and further their own core business by capitalising on the Krispy Kreme brand and offering their products. In addition Krispy Kreme would have access to a greater number of location without significant capital investment.

Removing large format stores from the portfolio would save roughly £13.2m<sup>16</sup> in leases, property, equipment and labour with an additional £0.5m raised from selling equipment, fixtures and fittings. Analysis of UK consumer cultural habits has proven this would have little to no detrimental effect on sales which should increase due to access to high favourable footfall areas, exploiting competitors' prime locations and asset base.

Krispy Kreme would focus exclusively on Doughnuts within the UK and exit the drinks market.

We estimate that each kiosk generate on average £120,000<sup>15</sup> of gross profit but with hugely reduced operating costs. At present Krispy Kreme's generate £14.6m of gross profit so this would equate to 125 mobile kiosks.

This recommendation addresses the challenges around rivalry by focussing Krispy Kreme on its core differentiator around its core product and capability, the doughnut. It also addresses the challenges Krispy Kreme face around its financial structure whilst allowing it to increase profitability.

## 6.2 Develop new distribution capabilities

Purchasing, maintaining and operating the mobile kiosks would require new resources and capabilities to be developed.

Mobile kiosks would need to be manufactured, maintained and operated efficiently.

The key to running a network of kiosks will be extending the network of production hubs that bake the fresh doughnuts and then deliver them to the kiosks. IT investment will be required to manage the new distribution chain and track stock levels and deliveries. An investment in logistics would be required to stock the kiosks.

Building this new distribution strategy will require some capital investment and a relationship building and negotiating with retail partners. It will also mean that they will lose

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<sup>15</sup> See [Appendix E](#) for an example

<sup>16</sup> See Appendix F

revenue from their other products such as coffee, however they will not require in-store staff and training costs will be cut dramatically, netting the cost differential.


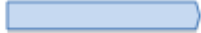
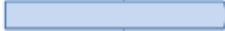




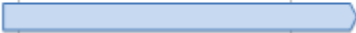
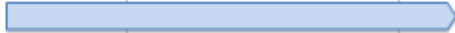



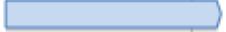
### 6.3 Sell direct online targeting businesses

In a recent pilot Krispy Kreme started selling doughnuts online. To further improve profitability we recommend Krispy Kreme target businesses as well where the average order is larger. We have shown that Krispy Kreme doughnuts are a popular sharing choice at business at meetings, for clients and at special events so this could be made easier with online ordering. It would also allow for easier repeat orders, such as automatic ordering for monthly meetings and more opportunity for viral marketing via packaging.

An additional short-term marketing campaign is recommended to increase awareness among business consumers; the campaign is also needed to manage any negative risk from large store closures.

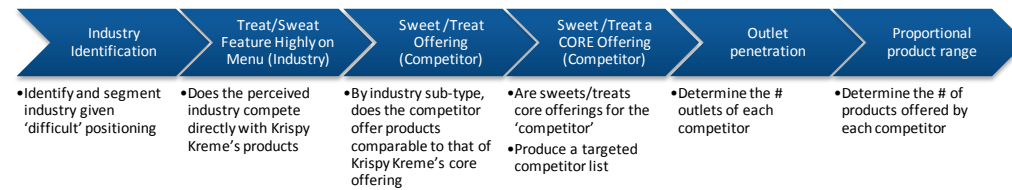
## 7 Implementation plan

We recommend the following implementation plan to take Krispy Kreme into long term UK profitability.

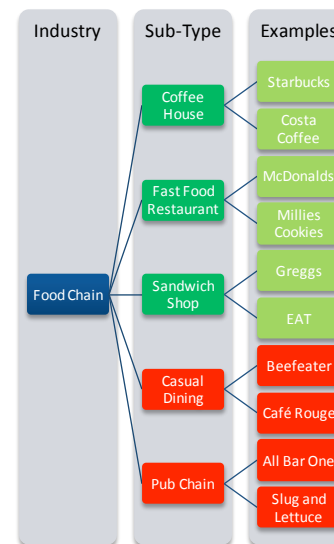
	Q1 2011	Q2 2011	Q3 2011	Q4 2011	> Q4 2011
<b>Objective:</b>	Brand awareness for business consumers	Short Term Stability	Short Term Profitability Cost Efficiency	Key product differentiation focus	Long Term Profitability
<b>New distribution capabilities</b>					
Strategy					
Kiosk manufacture					
Network hub extension					
<b>Large format store abandonment</b>					
Large store closures (lease-determined)					
<b>Mobile kiosks/retailers sales</b>					
Partner agreements					
Drinks withdrawn					
Kiosk Deployment					
<b>Sell direct online (businesses)</b>					
Online capacity changes					
Brand & product awareness / marketing					

## Appendix A – Competition Identification

- Krispy Kreme is a 'specialty retailer' and wholesaler of doughnuts.
- They operate under the following SIC/NAICS codes:
  - UK SIC 1581-Manufacture of bread; manufacture of fresh pastry goods and cakes
  - NAICS 2007 code(s) Core code: 3118-Bakeries and Tortilla Manufacturing; Primary code(s): 311811-Retail Bakeries 311812-Commercial Bakeries
- There is contention over whether they are a speciality eatery or quick service restaurant.
- To resolve this a simple industry identification/segmentation analysis was performed using the following process based on the quick service restaurant industry:



Competitor identification



This then led to the following detailed identification of competitors:



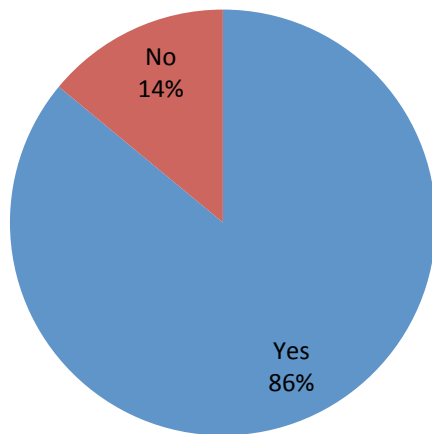
Food Chain Type	Company Likely Competitor (By #customers; revenue)	Sweet /Treat Offering	Sweet /Treat a CORE Offering	Outlet Penetration	Proportional Product Range
Coffee House	Café Nero	Y	Y	M	M
Coffee House	Caffè Ritazza	Y	Y	L	L
Coffee House	Coffee Republic	Y	Y	M	M
Coffee House	Costa Coffee	Y	Y	H	H
Coffee House	Starbucks	Y	Y	H	H
Fast Food Resturant	Burger King	N	N	H	
Fast Food Resturant	Domino's Pizza	N	N	H	
Fast Food Resturant	KFC	N	N	H	
Fast Food Resturant	Krispy Kreme	Y	Y	L	L
Fast Food Resturant	Little Chef	N	N	L	
Fast Food Resturant	McDonald's	Y	Y	H	H
Fast Food Resturant	Millie's Cookies	Y	Y	M	L
Fast Food Resturant	Pizza Hut	N	N	H	
Fast Food Resturant	Subway	Y	N	H	
Sandwich Shops	EAT	Y	N	M	
Sandwich Shops	Greggs	Y	Y	M	L
Sandwich Shops	O'Briens	N	N	L	
Sandwich Shops	Pret A Manger	Y	Y	H	
Sandwich Shops	Upper Crust	Y	N	M	

[http://wapedia.mobi/en/Krispy\\_Kreme\\_UK](http://wapedia.mobi/en/Krispy_Kreme_UK)

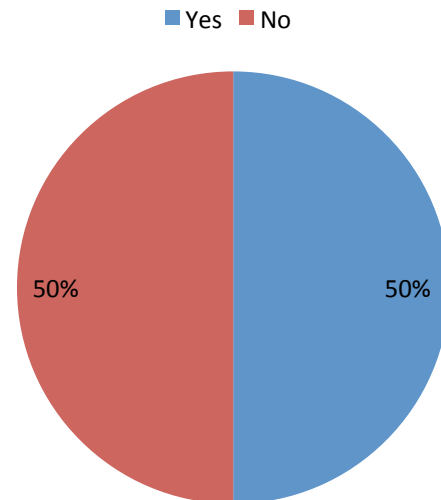
## Appendix B – Consumer Research

Research was carried out using [www.surveymonkey.com](http://www.surveymonkey.com) to 100 consumers representing a distributed sample of the UK population based upon age, income level and location.

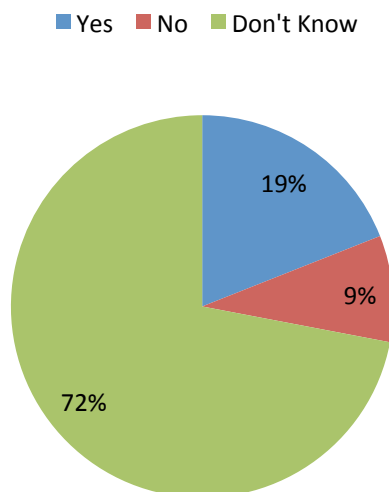
**Have you heard of Krispy Kreme?**



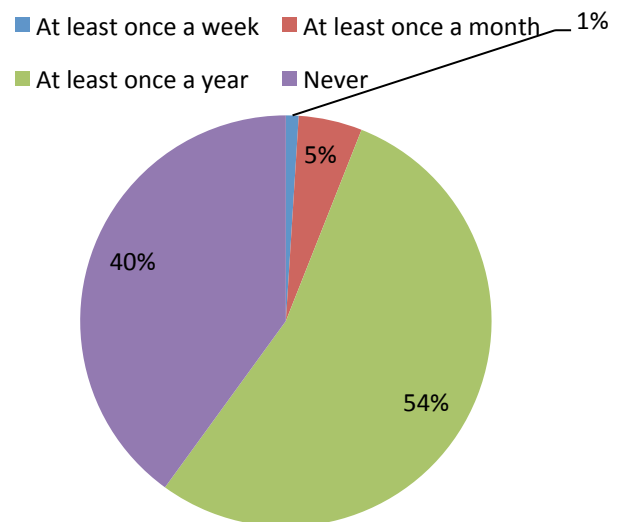
**Have you ever visited a Krispy Kreme Store or Kiosk?**



**Do Krispy Kreme make their donuts fresh?**

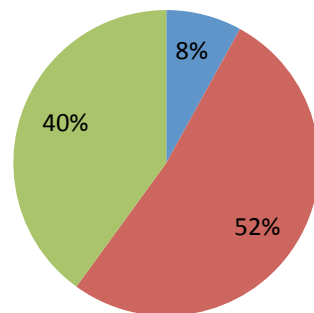


**How often do you eat Krispy Kremes?**



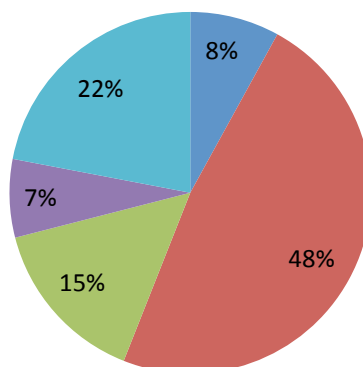
**The majority of times that you have eaten a Krispy Kreme, has it been an individual purchase or as part of purchase for the pupose of sharing**

■ Individual ■ Sharing ■ I have not eaten a Krispy Kreme



**If you purchase a Krispy Kreme donut, which of the following would be a major contributory factor**

■ Price ■ Product quality ■ Uniqueness of product  
■ Other ■ I would not purchase



## Appendix C – Interviews with Krispy Kreme Staff

Two informal interviews were carried out with staff from Krispy Kreme stores in Reading and Southampton. These were carried out on the 21st and 22<sup>nd</sup> December 2010 respectively.

The main points captured from both interviews were:

- Whilst both stores had glazing machines installed they were never used. Doughnut Theatre was not used at these locations and it was said to be the same at other stores in the UK.
- Both stores received a once a day delivery from their regional distribution centre (Portsmouth for Southampton and Staines for Reading).
- All doughnuts were delivered ready to sell and sat on racks until they were sold.
- The majority of customers were preferred to take away as opposed to eating in.

# Appendix D – Internal Analysis

## Internal value chain

The company operates a vertically integrated value chain supplying doughnut mix to all stores and manufacturing the doughnut machines that are used in all stores.

Supplying fresh doughnut mix to all stores:

- Begins with the secret recipe (formulation and consistency)
- Unique taste
- The mix is centrally produced, controlled and consistent and distributed to all stores and franchises

Manufacturing of proprietary doughnut-making equipment:

- Designs and manufactures the proprietary doughnut making equipment
- This is then sold to stores for profit and ensures consistency of end product

Retail distribution channels:

- Mixture and equipment is distributed to large factory stores from central hubs
- Mix of factory stores that supply smaller stalls and kiosks
- Outsourced retail channels in service stations and Tesco

Fresh doughnuts and doughnut theatre store experience:

- Worldwide locations
- Doughnuts are freshly baked and produced each day
- Original glazed sign
- Large capacity for production
- Simple product line

Sharing:

- Popular choice for sharing with friends, family, fellow workers and fellow students
- 60% of transactions are for more 12 doughnuts or more
- 75% of purchases at our domestic shops are for sharing occasions
- Sharing concept is an integral part of our global marketing approach

Cult brand:

- Targeted local campaigns (no above the line campaigns)
- Store demand is driven by word of mouth
- Very recognisable brand
- A lot of brand loyalty
- Drives demand for franchise opportunities

## Vision, Mission, Values

Mission:

- To touch and enhance lives through the joy that is Krispy Kreme.

Vision:

- To be the worldwide leader in sharing delicious tastes and creating joyful memories.

Values:

- Consumers are our lifeblood, the centre of the doughnut
- There is no substitute for quality in our service to consumers
- Impeccable presentation is critical wherever Krispy Kreme is sold
- We must produce a collaborative team effort that is unexcelled
- We must cast the best possible image in all that we do
- We must never settle for "second best;" we deliver on our commitments
- We must coach our team to ever-better results

## Appendix E – Mobile Kiosks

### Income

We suggest a kiosk that holds 500 doughnuts with a retail value of £500 (average price of £1.00 each) with each kiosk being stocked once per day (twice per day in larger stores such as Tesco), which means each kiosk could provide an estimated range of £300 to £1,000 per day in revenue.

Assuming most stores are open for business on average of 363 days per year this would give a range of £108,900 (assuming £300 per day) to £363,000 (assuming £1,000 per day).

### Expenses

Stocking the kiosk one or twice per day would require a network of lorries and drivers and also the paper bags and presentation boxes, estimated at £300 per day with additional gross costs for ingredients and boxes of £100 per day.

### Profit

Assuming average revenues of £200,000 per kiosk with 40% operating margin each kiosk would make a gross profit of £120,000.

### Capital requirements per kiosk

Each kiosk would cost around £4,000 to make, manufacture and equip.

### Conclusion

Assuming an average £235,000 of revenue per year depending on its location, in order to match the existing £30m of revenue generated in the UK 128 kiosks would need to be deployed at a cost of £512,000. The operating profit per kiosk is estimated to be around 60% which would represent £18m of operating profit per year.

The kiosks would have lower gross margins due to retailer margin and the increased distribution costs to stock the kiosks, however operating margins should be significantly increased.

## Appendix F – Financial Modelling

### Estimated cost savings by moving to mobile kiosk format

Capitalised leases:	£6.0m	(Currently £7.2m)
Operating leases:	£2.5m	(Currently £3.5m)
In-store staff costs:	£5.0m	(Currently £9.3m)
Total:	£13.2m	

All figures were taken from the UK company accounts.

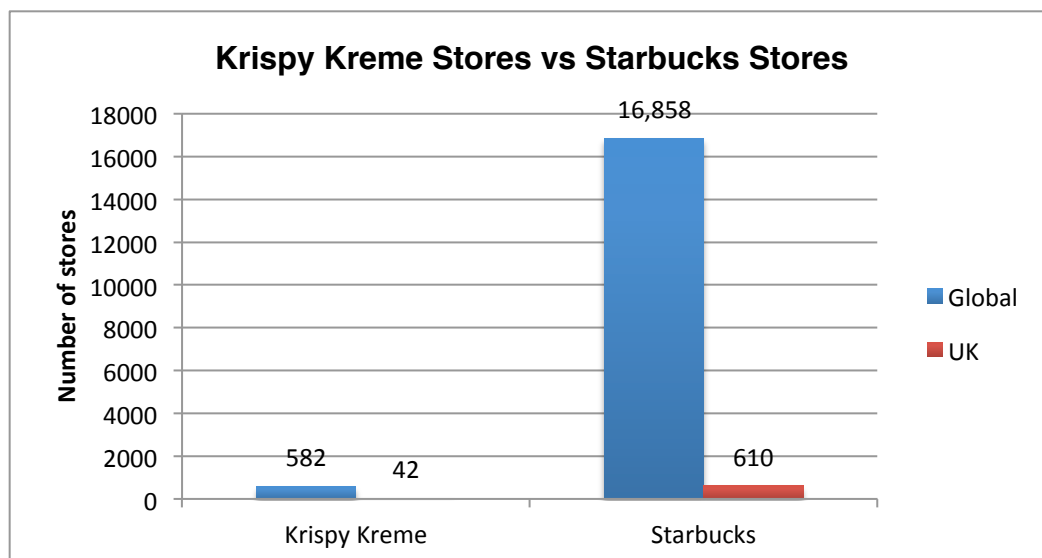
### Estimated income from selling existing store equipment

Store equipment:	£0.5m	(Currently £2.3m)
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All figures were taken from the UK company accounts.

### Estimated capital required compete with market leaders

Krispy Kreme state that estimated cost to fully outfit a Krispy Kreme location is about £1 million in the USA but in the UK the commercial market is landlord rather than freehold driven so we estimate that the cost to open a new store in the UK is about £500,000.

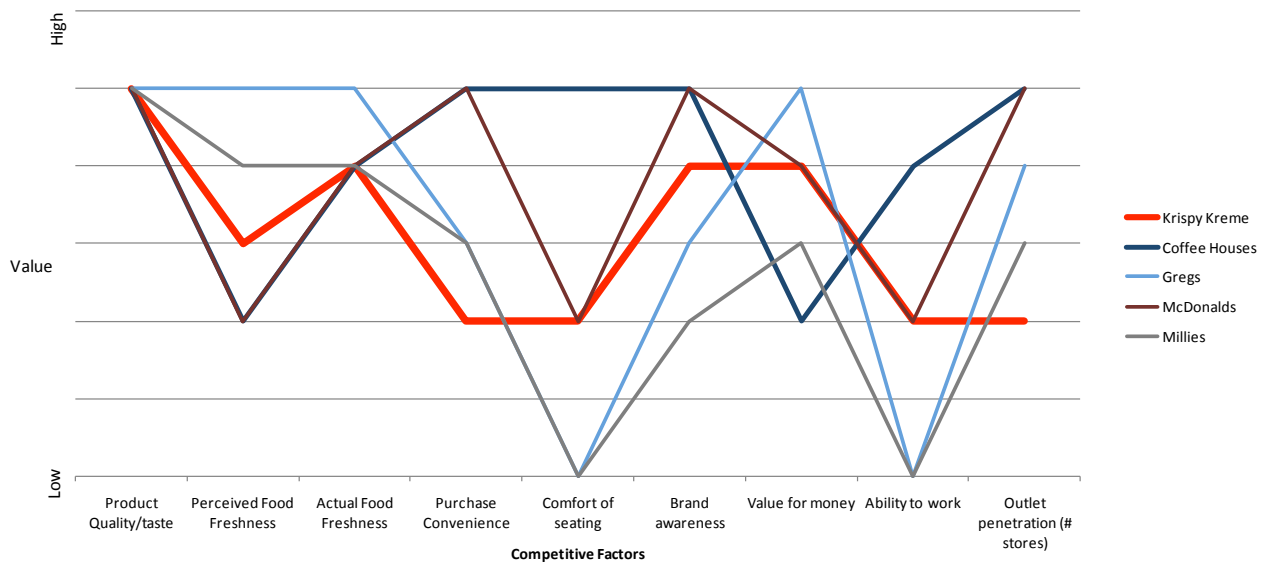


Krispy Kreme operates 42 stores in the UK compared with Starbucks 610. If Krispy Kreme were to grow to the size of Starbucks they would require approximately £284m.



## Appendix G – Value Curve Analysis

External factors of competition perceived or valued by customers as evidenced through our analysis is illustrated in the Value Curve below.



Value 1=Low; 5=High	Krispy Kreme	* Coffee Houses	Greggs	McDonalds	Pret a Manger	Millies Cookies
Product Quality/taste	5	5	5	5	5	5
Perceived Food Freshness	3	2	5	2	4	4
Actual Food Freshness	4	4	5	4	4	4
Purchase Convenience	2	5	3	5	4	3
Seating; comfort; social space	2	5	0	2	3	0
Brand awareness	4	5	3	5	4	2
Value for money	4	2	5	4	3	3
Ability to work	2	4	0	2	1	0
Outlet Penetration (# stores)	2	5	4	5	5	3

### \*Coffee Houses:

Starbucks  
Costa Coffee  
Café Nero  
Coffee Republic  
Café Retazza

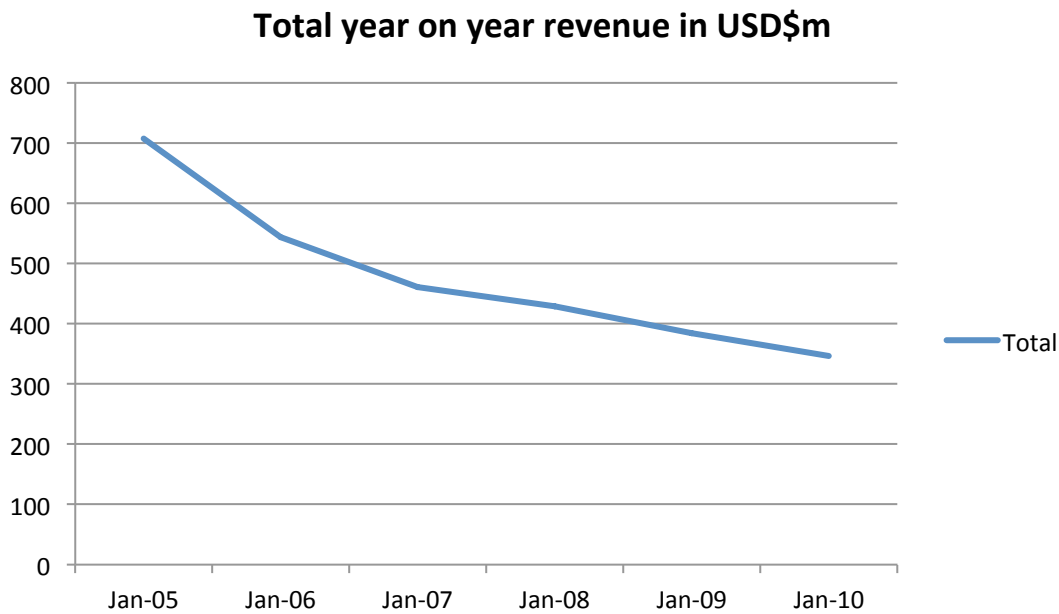
## Appendix H – How analysis can be improved

The results of this document are based upon limited analysis. This analysis could be improved further by:

- Access to Krispy Kreme executives and management to carry out a more thorough internal analysis.
- A larger consumer survey to increase the sample of the population and increase the quality of the results.
- More detailed research into UK property prices in high value locations.
- More detailed information on market sizing, market innovations and market trends

# Appendix I – Krispy Kreme historical Revenues

(Source: Reuters Jan 2011)



Millions USD \$					
Year Ended	Q1	Q2	Q3	Q4	Total
Feb-05	183.4	188.2	174.4	161.7	707.7
Feb-06	152.5	139.8	128.8	122.2	543.3
Feb-07	119.4	112.5	117.1	112.2	461.2
Feb-08	110.9	104.1	103.4	110.9	429.3
Feb-09	103.6	94.2	94.3	91.9	384
Feb-10	93.4	82.7	83.6	86.8	346.5

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