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Krispy Kreme, Inc. (DNUT) Q2 2024 Earnings Call Transcript

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Q2: 2024-08-08 Earnings Summary

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Press Release

10-Q

EPS of \$0.05 **misses by \$0.00** | Revenue of \$438.81M (7.32% Y/Y) **beats by \$4.81M**

Krispy Kreme, Inc. (NASDAQ:[DNUT](#)) Q2 2024 Earnings Conference Call August 8, 2024 8:30 AM ET

Company Participants

Josh Charlesworth - President & CEO

Jeremiah Ashukian - CFO

Conference Call Participants

Sara Senatore - Bank of America Merrill Lynch

Rahul Krotthapalli - JPMorgan

Bill Chappell - Truist Securities

Dan Guglielmo - Capital One Securities

Operator

[Abrupt Start]

<https://investors.krispykreme.com/> joining me on the call this morning are President and Chief Executive Officer Josh Charlesworth and Chief Financial Officer Jeremiah Ashukian. After prepared remarks, there will be a question and answer session. Before we begin, I would like to remind you that this call contains forward looking statements made pursuant to the Safe Harbor Provisions of the Private Securities and Litigation Reform Act of 1995 including statements of expectations, future events or future financial performance.

Forward looking statements involve a number of inherent risks and uncertainties, and we caution investors that these risks could cause actual results to differ materially from those contained in any forward looking statements. These factors and other risks and uncertainties are described in detail in the company's Form-10k filed with the SEC for the year ended December, 31, 2023 and in other filings we make from time to time with the SEC.

Forward looking statements made today are only as of today. The company assumes no obligation to publicly update or revise any forward looking statements, except as may be required by law. Additionally, today's call will include certain non-GAAP financial measures. A reconciliation between non-GAAP financial measures and our closest comparable GAAP measures can be found in our second quarter 2024 earnings press release and Form-8k filed today with the SEC and is also available at our investors.krispykreme.com, website.

Jeremiah will take us through our financial performance in a moment, but first, here's Josh.

Josh Charlesworth

Thanks Trey. Good morning everyone, and thank you for joining us. Our strategy of making fresh Krispy Kreme donuts more available around the world is working, and the excitement the brand creates has never been higher. This photo is from the recent opening of a Hot Light Theater in Ankara, Turkey, showing consumers lining up for our amazing, original glazed donuts hot off the production line. I want to thank our teams around the world for the great job they are doing making up fresh donuts available in more places, and for reminding people of the joy that is Krispy Kreme not just to eat but to share and give to others.

And as of tomorrow, Krispy Kreme will be available in 40 countries with the opening of our first Hot Light Theater in Morocco. The continuing strength of the brand and our strategy is reflected in our strong second quarter results. Organic revenue grew 7.8% driven by our innovative specialty donut collections, which continue to resonate with our consumers. Our global points of access continue to grow, increasing by 23% year over year. Our recently announced expansion into Spain means that fresh Krispy Kreme donuts will be available in four of Europe's largest markets next year. We are well on our way to our goal of 33,000 points of access by the end of 2026. In the U.S., our possible expansion was accelerating, which led to a U.S. margin increase of 80 basis points in the quarter. And we expect that as we build and optimize our Hub and Spoke Network, the efficiency benefits will continue to drive profitability.

The recent sale of Insomnia Cookies allows us to focus on our core strategy of producing, selling and distributing fresh donuts daily, whilst also further improving our financial profile. I am thankful for the partnership with Insomnia Cookies over the past five years, and look forward to continued success going forward, as a minority shareholder. Focused on fresh donuts now, excluding Insomnia Cookies, we expect full year organic revenue growth of 5% to 7%. In moment, Jeremiah will provide more details on the impact of the transaction and full year guidance as we continue on our journey of building a bigger and better Krispy Kreme in 2024 and beyond.

Let's expand on each of these key messages, starting with the continuing sales growth in Q2. We saw fantastic engagement with our brand again this quarter, with more than 27 billion media impressions as we capitalized on buzz worthy events like the solar eclipse as well as successful specialty donuts, including our Dolly Parton and Kit Kat Collections. Deliver fresh daily sales were up 18% globally and 22% in the U.S., where we have been driving donut category growth for our grocery and convenience store customers for more than a year now, digital sales grew 22% with the April relaunch of our U.S. loyalty program making the experience easier and more rewarding for our consumers. We can now deploy personalized consumer engagement across 15 million loyalty members, that's 27% more than a year ago.

Our biggest opportunity is to make it easier for people to buy our fresh donuts. We are doing this by increasing availability through our donut shops, online and by delivering fresh daily to grocery convenience stores and quick service restaurants and the pace of our expansion is accelerating. To reach our goal of 33,000 by 2026 we're expanding with existing customers, new customers, and indeed in new markets. With existing customers, such as Walmart, which still only lists us in about 25% of their stores, we are exploring the opportunity to go nationwide. We have agreed to expand with Target, a new customer later this year, and we are engaged in joint business planning with them to bring fresh donuts daily to their stores nationwide.

In new markets, our expansion in France and soon, Spain, Germany and Brazil provides the opportunity for 1000s more points of access. In Paris, we've quickly grown to five shops already, all supported by a single producing hub, and we have plans to enter DFD next year. In the U.S. our accelerated national expansion provides an opportunity to profitably densify our network. We currently have more than 8000 points of access in the U.S. We remain on track to add more than 12,000 McDonald's and about 3000 with partners like Walmart and Target, bringing them the goal to nearly 23,000 U.S. points of access by the end of 2026.

We are very pleased with our partnership with McDonald's. The national rollout begins this fall, with the Midwest, starting in Chicago, we expect to serve fresh donuts in more than 1000 McDonald's restaurants by the end of the year, add 5000 in 2025 and 6000 in 2026 bringing us to more than 85% of the U.S. footprint. Our team is hard at work modernizing the making and moving of donuts. We have a dedicated team partnering with our customers, including McDonald's, to ensure a smooth roll out. We are hiring and training experts in manufacturing operations, upgrading our donut production lines, continuously improving the manufacturing process and optimizing our delivery logistics network with improved routing and upgrades to our fleet, this expansion effort will increase utilization of our production hubs and distribution density. Today, our 151 U.S. Hubs with Spokes each serve on average 50 points of access. We expect this to increase to over 100 by 2026, improving efficiency and profitability.

Take, for example, Chicago, where we expect to support 450 new delivering fresh daily doors, with the same number of hubs as we have today. In addition to leveraging existing capacity, we'll be making selective investments in geographies which have limited access to Krispy Kreme today. Last quarter, I discussed adding 30 new hubs over the next three years to support the expansion. We're on track to achieve this goal, and have 17 of the 30 hubs already underway, including Seattle, Minneapolis and Philadelphia. With this, we are well positioned to deploy deliver fresh daily in all major metropolitan markets in the U.S.

And now I'll hand it over to Jeremiah to discuss our overall financial performance and the impact of the recent Insomnia Cookies transaction.

Jeremiah Ashukian

Thanks, Josh. I'll begin with our strong second quarter results, organic growth was 7.8% adjusted EBITDA increased 12.1% resulting in positive operating leverage with adjusted EBITDA margin expansion of 60 basis points to 12.5%. Turning to our U.S. segment results, the consumer engagement we saw in the quarter resulted in organic revenue growth of 8.4%, points of access growth was 17.8% year over year as we added new doors with several key customers and new stores including Stop and Shop and Target. Average revenue per door increased to \$657 driven by price and specialty donut collections.

This quarter, we saw a 6.4% increase in sales per hub to \$5 million which is a key measure of hub productivity. This helped deliver adjusted EBITDA growth of 16.4% to \$32.7 million. The margins improved 80 basis points year over year, to 11.3% driven by increased utilization and tight control of SG&A this was partially offset by increased promotional activity and startup costs for the McDonald's launch in the fall. Within our equity owned international markets, organic revenue grew 5% of all markets growing in the quarter, led by Canada and Japan. We continue to add points of access across the network, including Coles in Australia and Oxxo in Mexico.

Adjusted EBITDA declined 12.3% primarily driven by the UK market, which resulted in an adjusted EBITDA margin of 17.3%. We're focused on improving results in the UK, where performance has not been up to our expectations. We've completed the consolidation of three sites, which should yield benefits in the back half of the year, and are taking further actions to ensure we restore margin levels in this market. In our market development segment, organic revenue grew 16.1% as equipment sales increased year over year. System wide sales grew in most markets, most notably in South Korea, where digital sales and donut innovation have driven successful results. Adjusted EBITDA in the segment grew 22.7% with margin expansion driven by greater flow through from product sales. For the second quarter, we delivered \$0.05 and adjusted earnings per share. The higher depreciation and amortization in the quarter reflects the investments associated with expansion of our Hub and Spoke Network and Insomnia Cookies rapid growth.

Consistent with our plan, we delivered cash flow from operations in the second quarter of \$33 million taking us to \$15.5 million year to date. Since closing the quarter, we have strengthened our balance sheet following the sale of a majority ownership stake in Insomnia Cookies. We received \$127.4 million in cash proceeds upon closing on July 17, and have since collected an additional \$45 million following an Insomnia Cookies, refinancing of inter-company debt. As a result, we expect our next leverage ratio to trend towards 3.5 times by year end and remain on track to our long term goal of 2.0 times to 2.5 times by the end of 2026.

Let me turn to our full year guidance, which now reflects the sale of a majority ownership stake in Insomnia Cookies, improving the long term financial profile of the business. On the left you can see our previous guidance with a full year contribution from Insomnia. The middle column represents the back half impact of the transaction and on the right hand side is the Krispy Kreme's updated full year guidance, which reflects the removal of Insomnia from the second half of the year. By removing the previously forecasted \$120 million of Insomnia revenue from the guidance, we now expect net revenue of \$1.65 billion to \$1.685 billion. Consistent with our prior assumption that Insomnia would have 100 basis point impact to our overall growth, we expect organic growth of 5% to 7% for the full year. Removing Insomnia's, second half adjusted EBITDA results in Krispy Kreme adjusted EBITDA of \$215 million to \$220 million for 2024. As with all of these updates, the change to adjusted EPS solely reflects the recent sale of Insomnia. We now expect between \$0.24 and \$0.28 cents for the year.

We are also providing the following modeling assumptions, an income tax rate of between 28% and 30%, capital expenditures of 7% to 8% of net revenue and interest expense of \$55 million to \$60 million down from our prior guidance of \$55 million to \$65 million reflecting our lower net debt levels. With regards to the third quarter, we recognize the change in consumer dynamic and continue to respond to it. As a reminder, Q3 will reflect the removal of Insomnia, and as a result, we expect third quarter net revenue of \$370 million to \$383 million with adjusted EBITDA of \$38 million to \$41 million. We remain confident in our ability to execute throughout the remainder of 2024.

With that, I'll turn it over to Josh for his closing remarks.

Josh Charlesworth

Thanks, Jeremiah. I'm excited for what we have ahead in the balance of the year, particularly in our high season, which begins in September and runs through the year-end holidays. In summary, we're focused on expanding fresh donut availability by adding high quality, productive points of access, driving operating leverage to the efficiency of our operating model and maximizing capital return both by leveraging existing capacity and making selective investments in geographies which have limited access to Krispy Kreme today. All in I look forward to us building a bigger and better Krispy Kreme in the years ahead.

Operator, Let's now open it up to Q&A please.

Question-and-Answer Session

Operator

[Operator Instructions]. Your first question comes from the line of Sara Senatore with Bank of America Merrill Lynch.

Sara Senatore

Great. Thank you very much. I wanted to ask about you mentioned the McDonald's rollout, and just basically thinking about, are you still on track? I think the idea had been to kind of increase rateably the number of stores over time. Does that still sound like the right kind of roll out plan? And as a second point is, you know, I think you had, we'd seen some pretty significant investment ahead of that, whether it was an OpEx or G&A, are the biggest, kind of chunkiest increases behind us. And so going forward, you know, the growth rate in operating expense should lag or at least more closely match revenues. Thanks.

Josh Charlesworth

So yeah, good morning. Yeah, the McDonald's partnership is going very well in general, and the rollout is on track. We announced today that we will be first listing with McDonald's beyond the Kentucky pilot in the fall in Chicago, and then expanding through the Midwest in the back end of this year, and then obviously into next year, we expect to be in more than 1000 McDonald's restaurants by the end of 2024 and then we have a roll out plan that we have partnered with McDonald's on through 2025 and indeed through 2026 with about 5000 we're expecting to add, generally, evenly through the year of 2025.

We have a dedicated cross functional team there to make sure the facilities and our people are ready. In fact, we're also making improvements to the production lines and even doing our best to improve productivity and up our game as we go, we're very focused on delivering a really high quality service to the McDonald's restaurants so that people get awesome fresh donuts every day at the same quality level they expect in Krispy Kreme and other channels, perhaps Jeremiah do you want to talk about some of the impacts of that?

Jeremiah Ashukian

Yeah. And Josh, you did a nice job. Good morning, Sara, and thanks for the question. To ensure a smooth rollout, we are investing ahead of the opportunity with dedicated rollout teams to support our shops and training and development costs. We're also improving capabilities across our manufacturing and operations teams and upgrading your donut production lines, as you can imagine, the volume that will move through. All of this has been included in our guide. Ongoing, we expect to manage costs prudently and deliver margin expansion as we ramp the McDonald's network serving nearly 85% of the brand's U.S. footprint by 2026 as Josh mentioned.

Operator

Your next question comes from the line of Rahul Krotthapalli with JPMorgan.

Rahul Krotthapalli

Good morning, guys. Thanks for the great update. Today. I'd like to focus on the nationwide rollout of Walmart and Target, and this is, I feel is a very big step for you guys. I think today, as I understand, there are around 4000 to 5000 doors untapped just between these two brands, versus the 3000 odd non-McDonald's doors you guys discussed for the guidance for the next three years. So as you expand the Hub and Spoke infrastructure, is it fair to expect there will be almost no additions or very low or a lower mix of convenience stores or low volume doors editions, as we go along, expanding this side of the business and also will profitability follow this.

Josh Charlesworth

It's important to understand that the McDonald's nationwide expansion is a bit of a catalyst for us. It enables us to really expand our DFD business faster than we would have been able to otherwise, and so we're focused on naturally, the high quality national players you mentioned, Walmart, Target, Kroger and others all fit the bill, all ways of getting our consumers those fresh donuts and making it easier for them to purchase them than it is today. So you know, we're in discussions with Walmart about how as our hubs are available to produce donuts in more and more markets. We can get it to those additional Walmart stores. We began discussions with Target as well, and they've evolved quickly, and we've recently expanded with Target at Phoenix and Atlanta, and we've got plans to come to LA, Detroit and several cities as we build out the network with the rollout of McDonald's.

So it's it really is a great combination sea stores [ph] and other smaller locations, smaller lower traffic locations are actually still very helpful to us, though, because we think all the places you go on the way to a McDonald's, Target, Walmart, Kroger, you're going to be going past convenience stores, gas stations, making the logistics route efficient, and so we still see a role for those to play, but naturally, we're focused on those big national partners that the McDonald's program unlocks for us.

Rahul Krotthapalli

Thanks for that. And I have a follow up on the international side. Can you discuss the details on what's happening in the UK market today, there has been concerns around broader softening demand in the QSR space. I'm just curious to understand how Krispy Kreme's business in that core market is holding up. How is it tracking related to your expectations? Anything here would be helpful.

Josh Charlesworth

Well, it's true that the UK has been a challenge that we're focused on, but it is important to understand that the majority of our near 40 international markets continue to perform very well, and we have company owned, Japan, Canada, Australia, most of our franchisee partners, newly opened, France, all performing very well, and indeed, the UK is still growing. It's just at a slower rate than the others, and profitability has been disappointing as a result. But the team have created some local buzz recently in July with specialty donuts following the strategy that's worked out elsewhere. They celebrated the TV show Friends. Just yesterday, we announced upgrades to the core donut range coming in Q3 so there's a lot of adaptation to those conditions you described that the team are doing well, not just on the top line or actually, you know, also worth mentioning about 200 secondary displays in grocery stores that are working well in larger supermarkets, expansion into convenience stores. So a lot of focused effort to get the UK back up to the levels we're seeing in other international markets, all whilst managing the cost side as well that Jeremiah covered earlier. So you know, I understand why you ask about the UK. We're closely monitoring and supporting the team there to make sure we get performance back up to the levels we're seeing elsewhere.

Operator

Your next question comes from the line of Bill Chappell with Truist Securities.

Bill Chappell

Josh, just a quick follow up on the UK. I was, I mean, I thought the impression that more of the issue was a regulatory one, and that you would start to be kind of lapping that. So maybe any update there in terms of, just, are you laughing, should things get better on their own? Is it getting any worse? Were you hearing more noise on that front just from that standpoint, would be great.

Josh Charlesworth

Hi, Bill, yeah, I mean the regulatory changes you're referencing associated largely impact in terms of where displays can be placed in a grocery store, associated with regulations around the merchandising of sweet treats there, that definitely has been a challenge for the team, and hence the secondary displays I mentioned, the additional expansion into convenience stores. These are great tactics the teams have employed.

We are lacking the initial impact of those regulations to your question, but it obviously has brought a structural effect onto the market. But then you know, when you step back and look at the brand, the donuts, how the consumer is resonating with our product, there's definitely an opportunity in the UK, hence, focus on upgrading the core donuts, bringing out specialty arts [ph], as we see in other markets. And the team are really leaning into that. So obviously the macroeconomic environment has been relatively challenged in the UK, but our teams generally focus on these amazing moments of joy, celebratory occasions and so looking forward, I know they're really getting behind all the big special occasions we have in the high season months ahead of us.

Operator

[Operator Instructions]. Your next question comes from the line of Dan Guglielmo with Capital One Securities.

Dan Guglielmo

Hello everyone. Thank you for taking my questions. Just around like the big U.S. relationship expansion so McDonald's, Target and then possibly Walmart. Will you all need to hire in the U.S. in the second half of this year, or can the existing employee base kind of handle most of that?

Josh Charlesworth

Well, obviously we're gearing up for expansion already, in many ways that is making sure that we've got extra drivers in place to get the donuts out there. That's the main hiring initiative we'd expect in the early months nearly all of the expansion is serviced by existing production hubs. So it's quite small the amount of extra labor we need to support the production there. We do have teams focused on partnering with the customers, you can imagine, in customer service and in marketing and for example, our respective marketing teams are working closely together with the McDonald's team, you know, so that people know Krispy Kreme is coming to McDonald's. So there is investment there but the overall message is that the expansion of deliver fresh daily in the U.S. is leveraging an underutilized system, the additional densification of all that distribution means you get flow through to the bottom line, as we saw in this quarter, in the second quarter, which we're pleased to see. You know, overall organic growth, basis point improvement reflects the model we have here, and so recruitment of the right people to support that is important, but it isn't a big concern. In fact, it's really exciting to see how we're growing.

Dan Guglielmo

Great. Yeah, that's very helpful. And just kind of as a follow up to that, just kind of U.S. macro a little bit the new employees, kind of that you're bringing, bringing on, like, how has the labor environment looked? Is it competitive? Just kind of curious from your view?

Josh Charlesworth

Krispy Kreme has been well positioned I feel. People love working at a Krispy Kreme. It's a great environment to work in and so generally, across the board, we've been able to recruit great talent and great people across the system. And there were stages where hiring drivers was a little more difficult. We're not seeing the same challenge. I think the labor environment has eased up on that, on that side, and so, yeah, the main thing we're focused on and making sure that all those folks are trained and supported, that the equipment is in tip top condition, that we have optimized our delivery routes, also that we can service our customers needs.

Operator

Your next question comes from the line of Bill Chappell with Truist Securities

Bill Chappell

Me again. I got cut off. Josh just a question on Chicago. You know why that's the next city? It's obviously different from the Kentucky cities. It's in the backyard and front yard of McDonald's headquarters and I don't know what kind of your existing presence is compared to other cities, so maybe you could just kind of explain the thought process behind that, and kind of how that may be different or not from what you've seen in Lexington and Louisville.

Josh Charlesworth

Well it is certainly different, but we're excited to be there at the home McDonald's. We're guided by their teams, where they prefer to roll out first, only constrained by our existing capacity, as I mentioned earlier in the call, you know, we're investing in -- selectively in key markets around the country, identifying and even getting commitments on sites in places like Minneapolis and Boston that we don't have production, and we'll come to those later. But in Chicago, we have three hubs with spokes already. They have excess capacity. In fact, in one of the sites, we have a hub with more than one production line, and so it's made complete sense to start in a place where we had that. As we think about our hubs going forward, we're really working on creating streamlined, sort of high efficiency sites that seamlessly integrate DFD and retail operations and we actually already have somewhere that we've been able to with modest investment set up in that way. So I feel really confident about starting out in Chicago. We have a nice presence across the Midwest in general. So you know, get going with a really positive, strong momentum from the start makes sense for both of us. So we're excited for the teams there.

Operator

I'll now turn the call back over to Josh Charlesworth for closing remarks. Please go ahead.

Josh Charlesworth

Yes. Well, thanks everyone for the questions. Really appreciate it. Thank you for your interest in Krispy Kreme today, obviously strong results and the strategies working. So really pleased to share with you that today. And of course, thank you to our Krispy Kremers for your ongoing commitment, bring joy to our customers through Krispy Kreme around the world. Thank you very much.

Operator

Ladies and gentlemen, that concludes today's call. Thank you all for joining and you may now disconnect.

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