12 May 2016

Krispy Kreme Doughnuts (KKD) / JAB

Agreed Merger

A counter bid for KKD is highly unlikely, in our view.

IGR view: We believe that the offer price for KKD is full and fair. In addition, we don't see another bidder for KKD with similar synergy potential. Consequently, we would not be long KKD at its current share price.

- We don't see any regulatory issues for the deal and we expect deal close by mid-August 2016.
- We believe that JAB is a strong and committed bidder (as is reflected by the DMA risk sharing provisions).

Strategic driver: We believe that the deal is driven by JAB's coffee franchise. It has been noted by analysts that coffee is a much higher-frequency purchase in general for U.S. consumers than is doughnuts. In fact, KKD states in its 10-K that "We also believe that increasing the percentage of retail consumers who purchase a beverage when visiting our shops has great potential for growing both revenues and profitability."

- KKD has stated that sales of doughnuts comprise approximately 89% of total retail sales, with the balance comprised principally of beverage sales. At competitors such as Dunkin' or Tim Hortons, the share of higher margin coffee sales is much higher.
- We note that there already is cooperation between KKD and Keurig Green Mountain, and we believe that both companies are likely to focus on growing sales and increasing profitability margins at KKD through a greater emphasis on beverages and coffee.
    - We note that this may also limit the circle of potential counter bidders as well.
        - Other potential bidders may not have such a synergy advantage.

DMA: We believe that the DMA is standard and has sufficient protection for KKD shareholders.

- Financing: The deal is not conditional on financing. We believe that financing will not be an issue for JAB.
- Antitrust: Although there is no reverse break fee, given the lack of any significant overlap we do not expect any antitrust issues.
    - There appears to be no limitation as to antitrust related remedies. The clause appears to be highly similar to the GMCR antitrust clause:

Valuation: We estimate that the deal is in line with precedent transactions in the coffee and consumer industry. On this basis, we expect that KKD shareholders will approve the deal.

- By our ROIC analysis, we estimate that JAB is likely to be assuming significant cost and revenue synergies from the transaction. We believe that it is unlikely that other bidders would have access to similar synergy opportunities.

Merger Terms

1 KKD = $21.00 in cash

Target: Krispy Kreme Doughnuts, Inc.

Country	United States
Bloomberg	KKD
Sector	Restaurants
Share price ($)	21.03
Market cap ($m)	1,308
Free float (%)	100

Acquirer: JAB Holdings B.V.

Krispy Kreme Doughnuts Price Chart

Author

Krisztian Szentessy
Senior Event Driven Analyst
krisztian@independentglobal.com
+44 207 570 0322 (direct line)

Krisztian Szentessy
krisztian@independentglobal.com
Gabor Kokosy
g.kokosy@independentglobal.com
Tomas Stanay
t.stanay@independentglobal.com
Gabor Szabo, CFA
g.szabo@independentglobal.com

Independent Global Research
100 Wall Street, 20th Floor
New York, NY 10005
Tel (UK): +44 207 570 0322
Tel (New York): +1 212 796 5769

Key terms of the merger

Transaction Details

Announcement Date	*9 May 2016*
Offer structure	*All Cash Merger*
Offer terms	*1 KKD = $21.00 in cash.*
Deal size	*$1.35bn (equity value)*
% owned by KKD shareholders	*0%*
Voting agreement	*N.A.*
Target's Board Recommendation	*Yes.*
KKD Inc.	*North Carolina*
JAB Holdings B.V.	*The Netherlands*
Merger Agreement	*Click here for the merger agreement*
Synergies	*JAB has not indicated any cost savings estimate.*

- *At the close of the transaction, Krispy Kreme will be privately owned and will continue to be independently operated from Krispy Kreme's current headquarters in Winston-Salem, N.C.*

Deal completion

The transaction is not subject to a financing condition and is expected to close in the third quarter

Dividends

KKD is not allowed to pay any dividends under the DMA.

Financing

The transaction is not conditional on financing.

Capital Structure

KKD equity	*60,914,289 Shares are issued and outstanding as of May 6, 2016*
KKD debt	*The $40 million 2013 Revolving Credit Facility is KKD's principal source of external financing.*
Net leverage	*Net Cash*
KKD Credit rating	*N.A.*

Marketing period

None.

Deal close definition

Closing will take place no later than the third Business Day following the satisfaction of the merger conditions.

Timetable

Confidentiality Agreement	*April 8, 2016*
Date of the Merger Agreement	*May 8, 2016*
Deal Announcement	*May 9, 2016*
HSR filing	*By end of May 2016*
Prelim proxy filing by date	*By end of May 2016*
Expiration of HSR waiting period	*By end of June 2016*
Definitive proxy	*By end of June 2016*
KKD shareholder meeting	***By mid-August 2016***
Deal close	***By mid-August 2016***
Outside Date	***November 8, 2016***

Solicitation Clause

There is a non-solicitation clause with fiduciary out, at any time prior to the KKD shareholder meeting:

- *There is a 3 business day matching period.*

*A **superior proposal:** A proposal that that the KKD Board determines in good faith taking into account, among other things, all legal,* *financial, regulatory, timing and other aspects of the Acquisition Proposal and the Person making the Acquisition Proposal (including any break-up fees, expense reimbursement provisions, the availability of financing, and any conditions to consummation relating to financing, regulatory approvals or other conditions beyond the control of the party having the right to invoke the condition) and other aspect of the Acquisition Proposal that the board of directors of the Company deems relevant*

- *(i) is more favorable to the Company's shareholders from a financial point of view than the transactions contemplated by this Agreement (after taking into account any changes to the terms of this Agreement proposed by Parent and any other information provided by Parent pursuant to Section 6.3(c)) and*
- *(ii) is reasonably likely to be consummated*

Key conditions to the merger

Shareholder approvals	***Yes**.* ■ ***KKD**: The affirmative vote of the holders of not less than a majority of all outstanding Shares entitled to vote pursuant to a vote at a special meeting of shareholders.*
No injunctions	***Yes.***
No legal restraints	***Yes.***
Regulatory Approvals	***Yes.*** ■ *HSR*
Reps and warranties	***Yes.***
Covenants fulfilled	***Yes.***
No KKD MAC	***Yes** (in addition to reps and warranties are qualified by MAC)*
Certificates	***Yes.***
Financing	***No.***

KKD MAC Definition

Events that would have a material adverse effect on

- *(a) the financial condition, business or results of operations of the Company and its Subsidiaries taken as a whole*
- *(b) the ability of the Company to consummate the transactions contemplated by this Agreement.*

KKD MAC Carve-outs to (i)

- *Effects resulting from changes in the economy, political conditions or financial credit or securities markets generally in the United States or other countries in which the Company conducts material operations or sources material supplies or that are the result of acts of war or terrorism;*
  - ***no disproportionate impact.***
- *Effects resulting from changes that are the result of factors generally affecting the industries in which the Company and its Subsidiaries operate, including changes in raw material costs*
  - ***no disproportionate impact.***
- *Effects resulting from changes in United States generally accepted accounting principles ("GAAP") or rules and policies of the Public Company Accounting Oversight Board or changes in applicable Law or changes in interpretations of applicable Law*
  - ***no disproportionate impact.***
- *Effects resulting from (i) any failure by the Company or its Subsidiaries to meet any internal or external projections, budgets, guidance, forecasts, estimates of revenues or earnings by the Company or its Subsidiaries or analysts or (ii) change in the market value or trading volume of Shares for any period ending on or after the date of this Agreement*
  - ***underlying cause exemption***
- *Effects directly resulting from entry into this Agreement, the public announcement or pendency of the Merger or the other transactions contemplated by this Agreement (including, for the avoidance of doubt, (i) any loss of revenue or earnings, or (ii) the impact thereof on the relationships, contractual or otherwise, of the Company or any of its Subsidiaries with employees, customers, suppliers or business partners, in each case solely to the extent resulting from such public announcement or pendency)*
- *any Effect relating to any action taken by the Company with Parent's consent or contemplated expressly by this Agreement or any action not taken by the Company to the extent such action is expressly prohibited by this Agreement without the prior consent of Parent the Company has requested the consent of Parent to take such action and Parent has not consented to such action within five business days;*
- *the existence, occurrence, or continuation of any earthquakes, floods, hurricanes, tropical storms, fires or other natural disasters or any national, international or regional calamity*
  - ***no disproportionate impact.***

Break fees

Break Fee	■ *There is a $42m break fee payable by KKD under certain circumstances.* ○ *3.1% of deal value or ~$0.7 per KKD share.*

Reverse Break Fee	*None.*

Antitrust related clauses

Jurisdictions	*U.S. (HSR)*
Divestiture obligation	*Yes (there appears to be no limitation to antitrust remedies)*
Litigation obligation	*Yes.*
Reverse break fee (regulatory)	*No.*

Specific Performance

Yes.

Governing Law

Laws of the State of NY.,

Key KKD shareholders	%
T Rowe Price	*15.3%*
Vanguard	*7.1%*
Blackrock	*5.5%*
Wells Fargo	*4.9%*
Dimensional Fund	*3.4%*
Stephens Inv Mgt	*2.9%*
Morgan Stanley	*2.7%*
Penn Cap Mgt	*2.5%*
Waddell & Reed	*2.4%*
William Blair	*2.2%*
Others	***51.1%***

Rationale for the acquisition of KKD by JAB

KKD DESCRIPTION

KKD revenues by product segments

$m	FY2015	FY2016	% of total	4yr CAGR
Company Stores	**$325**	**$349**	**67%**	**6.5%**
On-Premise Sales	$167	$190	37%	10.9%
Wholesale Sales	$158	$159	31%	2.2%
KK Supply Chain	**$245**	**$255**	**49%**	**5.4%**
International Franchise	**$29**	**$28**	**5%**	**5.2%**
Franchised Royalty Revenue	$27	$26	5%	4.9%
Development and Franchise Fees	$2	$2	0%	10.6%
Domestic Franchise	**$13**	**$15**	**3%**	**13.1%**
Franchised Royalty Revenue	$12	$13	3%	11.1%
Other	$1	$1	0%	33.6%
Development and Franchise Fees	$1	$1	0%	26.0%
Total	**$490**	**$519**	**100%**	**6.5%**

Source: Bloomberg and IGR.

KKD is a leading branded retailer and wholesaler of high-quality doughnuts, complementary beverages, and treats and packaged sweets. KKD stores offer a wide variety of high-quality doughnuts, including the Company's Original Glazed® doughnut, together with complementary products, including a broad array of coffees and other beverages.

- As of January 31, 2016, there were 297 Krispy Kreme stores operated domestically in 41 states and in the District of Columbia, and there were 824 shops in 25 other countries around the world.
    - Of the 1,121 total stores, 370 were factory stores and 751 were satellites.
- KKD and its franchisees sell products through two channels:
    - On-premises: Sales to customers visiting KKD and franchise stores, including sales made through drive-thru windows, along with discounted sales to community organizations that in turn sell doughnuts for fundraising purposes. A substantial majority of the doughnuts sold in KKD shops are consumed elsewhere.
    - CPG: Sales of fresh doughnuts and packaged sweets primarily on a branded basis to a variety of retail customers, including convenience stores, grocery stores and mass merchants and other food service and institutional accounts.
        - These customers display and resell the doughnuts and other products from self-service display cases, and in packages merchandised on stand-alone display units or on the retailer's shelf.
        - Products are delivered to customer locations by KKD's fleet of delivery trucks operated by a commissioned employee sales force or, occasionally, by independent third-party distributors.
        - Distribution through CPG sales channels generally is limited to stores in the United States. Only a small minority of sales by international franchisees are made to CPG customers.
- KKD generates revenues from four business segments:
    - Company Stores: The Company Stores segment is comprised of the doughnut shops operated by the Company.
    - Domestic Franchise: The Domestic Franchise segment consists of KKD's domestic store franchise operations and the licensing of Krispy Kreme products domestically.
        - KKD began licensing complementary products in the beverage category when KKD signed an agreement for the test of Krispy Kreme branded bagged coffee at approximately 100 wholesale club locations in the southeastern United States.
        - In calendar 2014, KKD signed agreements for the introduction of Krispy Kreme branded ready-to-drink coffee beverages in bottles for distribution at approximately 900 mass merchant locations throughout the United States, and also **signed an agreement with Keurig Green Mountain to bring Krispy Kreme branded coffee to the Keurig® brewing system.**
            - Krispy Kreme coffee is available in K-Cup® packs at grocery stores, convenience stores and big box outlets throughout the U.S., as well as at Krispy Kreme shops and online
    - International Franchise: The International Franchise segment consists of KKD's international store franchise operations. International franchise stores sell doughnuts and complementary products almost exclusively through the on-premises sales channel using shop formats similar to those used in the United States, and also using a kiosk format.
    - KK Supply Chain: The KK Supply Chain segment produces doughnut mixes and manufactures doughnut-making equipment, which all factory stores, both Company and franchise, are required to purchase.

KKD revenues by geographic segments

$m	FY2015	FY2016	% of total	4yr CAGR
United States	$439	$470	91%	6.8%
Asia Pacific	$29	$25	5%	6.0%
Rest of World	$9	$10	2%	3.7%
European Union	$7	$7	1%	8.1%
Middle East	$6	$5	1%	-8.7%
South America	$1	$1	0%	n.a.
Africa	n.a.	$1	0%	n.a.
Total	**$490**	**$519**	**100%**	**6.5%**

Source: Bloomberg and IGR.

Competition: KKD's competitors include a wide range of retailers of doughnuts and other treats, coffee shops, other café and bakery concepts

- There is an industry trend towards expanded fresh product offerings at convenience stores during morning and evening drive times, and products are either sourced from a central commissary or brought in by local bakeries.
- In the packaged doughnut market, an array of doughnuts is typically merchandised on a free-standing branded display.
- KKD competes for sales with many sweet treats, including national brands, such as Dolly Madison, Entenmann's, Little Debbie, Sara Lee and Hostess, and also regional brands.

STRATEGIC DRIVERS

We believe that the deal is driven by JAB's coffee franchise. It has been noted by analysts that coffee is a much higher-frequency purchase in general for U.S. consumers than is doughnuts. In fact, KKD states in its 10-K that "We also believe that increasing the percentage of retail consumers who purchase a beverage when visiting our shops has great potential for growing both revenues and profitability."

- KKD has stated that sales of doughnuts comprise approximately 89% of total retail sales, with the balance comprised principally of beverage sales. At competitors such as Dunkin', the share of higher margin coffee sale is much higher.
- We note that there already is cooperation between KKD and Keurig Green Mountain, and we believe that both companies are likely to focus on growing sales and increasing profitability margins at KKD through a greater emphasis on beverages and coffee.
    - We note that this may also limit the circle of potential counter bidders as well.
        - Other potential bidders may not have such a synergy advantage.

Key risks to the completion of the deal

DMA: We believe that the DMA is standard and has sufficient protection for KKD shareholders.

- Financing: The deal is not conditional on financing. We believe that JAB has a strong balance sheet, and consequently financing will not be an issue for the deal.
- Antitrust: Although there is no reverse break fee, given the lack of any significant overlap we do not expect any antitrust issues.
    - There appears to be no limitation as to antitrust related remedies.
        - The clause appears to be similar to the GMCR antitrust clause:
            - The GMCR DMA required JAB to accept "operational restrictions or limitations on, and committing to or effecting, by consent decree, hold separate orders, trust or otherwise, the sale, license, disposition or holding separate of, such assets or businesses of Parent, Acquisition Sub, the Company, the Surviving Corporation or any of their respective Affiliates (and the entry into agreements with, and submission to decrees, judgments, injunctions or orders of such Governmental Authority) as may be required to obtain such Antitrust Clearances or to avoid the entry of, or to effect the dissolution of or vacate or lift, any decrees, judgments, injunctions or orders under any Antitrust Laws that would otherwise have the effect of preventing or materially delaying the consummation of the transactions contemplated by this Agreement, including the Merger."
            - The KKD DMA required JAB to accept "operational restrictions or limitations on, and committing to or effecting, by consent decree, hold separate orders, trust or otherwise, the sale, license, disposition or holding separate of, such assets or businesses of Parent, Merger Sub, the Company, the Surviving Corporation or any of their respective

Affiliates (and the entry into agreements with, and submission to decrees, judgments, injunctions or orders of such Governmental Entity) as may be required to obtain such Antitrust Clearances or to avoid the entry of, or to effect the dissolution of or vacate or lift, any decrees, judgments, injunctions or orders under any Antitrust Laws that would otherwise have the effect of preventing or materially delaying the consummation of the transactions contemplated by this Agreement, including the Merger."

- MAC: We note that the deal is conditional on there being no Company MAC.
  - There would have to be a disproportionate catastrophic event affecting KKD in a relatively short period of time.

Jurisdictions and timeline: The key jurisdictions is the U.S.

- On this basis, we expect a three month timeline with the deal closing by mid-August 2016.

Antitrust risks: We believe that significant antitrust issues are unlikely to arise

- There is some overlap between the companies.
  - JAB took over DE Master Blenders for €7.6bn in 2013, following the $340m acquisition of the Caribou Coffee chain and the Peet's Coffee & Tea chain for $1bn. It has control of the new Jacobs Douwe Egberts (JDE) group – named after the main coffee business of Mondelez and DEMB – with a 54 per cent stake.
  - Earlier this year, JAB acquired Keurig Mountain.
- We note, however, that the relevant product market is likely to be defined fairly widely (similarly low quality coffee is available at McDonald's, for example).
  - On this basis, competition is likely to be highly intense in the relevant product market even if geographically the relevant market is defined narrowly.

Valuation of KKD

PRECEDENT TRANSACTIONS

Precedent transaction analysis

Retail Coffee and Tea Precedent Transactions			
Ann. Date	**Target**	**Acquirer**	**LTM EBITDA multiple**
May-16	Krispy Kreme	JAB Holdings (Benckiser)	16.1x
Aug-14	Tim Hortons	Burger King	17.0x
Dec-12	Caribou Coffee (retail)	JAB Holdings (Benckiser)	12.0x
Nov-12	Teavana (retail)	Starbucks Corp	17.4x
Jul-12	Peet's Coffee & Tea (retail)	JAB Holdings (Benckiser)	22.3x
Coffee and Tea Precedent Transactions			
Mar-13	DE Master Blenders	JAB Holdings (Benckiser)	18.0x
Apr-12	United Coffee	UCC Holdings Co., Ltd.	n.a.
Oct-11	SLE Foodservice (Sara Lee Corp. business unit)	The J.M. Smucker Company	n.a.
May-11	Rowland Coffee Roasters, Inc.	The J.M. Smucker Company	n.a.
Sep-10	Van Houtte, Inc.	Green Mountain Coffee Roasters	13.2x
Nov-09	Diedrich Coffee, Inc.	Green Mountain Coffee Roasters	35.2x
Nov-09	Timothy's Coffees of the World, Inc.	Green Mountain Coffee Roasters	19.4x
Jun-08	The Folgers Coffee Company	The J.M. Smucker Company	8.5x
Mar-08	Timothy's Coffees of the World, Inc.	Sun Capital Partners, Inc.	11.1x
May-07	Van Houtte, Inc.	Littlejohn & Co., LLC	8.4x
Jun-06	Eight O'Clock Coffee Company	Tata Tea, Ltd.	8.1x
Oct-05	SLE Retail (Sara Lee Corp. business unit)	Massimo Zanetti Beverage USA	8.3x
High-Growth Consumer Precedent Transactions (last 5 years)			
Ann. Date	**Target**	**Acquirer**	**LTM EBITDA multiple**
Mar-11	Yoplait, S.A.S.	General Mills, Inc.	13.2x
Sep-09	Cadbury PLC	Kraft Foods, Inc.	13.7x
Apr-08	Wm. Wrigley Jr. Company	Mars, Inc	18.3x
Dec-15	Keurig Green Mountain	JAB Holdings (Benckiser)	13.6x

Source: IG Research & Bloomberg.

Precedent transactions: We estimate that the deal is in line with precedent transactions in the coffee and consumer industry. On this basis, we expect that KKD shareholders will approve the deal.

ROIC ANALYSIS

By our ROIC analysis, we estimate that JAB is likely to be assuming significant cost and revenue synergies from the transaction. We believe that it is unlikely that other bidders would have access similar synergy opportunities.

ROIC calculations

Deal value	**2019**
Bid price ($/sh.)	*$21.00*
O/S (m)	*64*
Market value ($m)	**$1,348**
Net Debt ($m)	-$39
Deal value ($m)	**$1,309**
ROIC calculation	
BEST EBIT (BEST median)	**$80.3**
Synergies	*$30*
Adj. Operating Profit	**$110**
Tax (35%)	*$39*
NOPAT	**$72**
ROIC	**5.5%**
WACC	**8.0%**

Source: Bloomberg, company reports, and IGR.

ROIC sensitivity table

BEST EBIT vs offer price

		Bid price ($/share)				
		$21.00	**$22.00**	**$23.00**	**$24.00**	**$25.00**
2019 EBIT ($m)	**$70.0**	5.0%	4.7%	4.5%	4.3%	4.2%
	$75.0	5.2%	5.0%	4.7%	4.5%	4.4%
	$80.3	5.5%	5.2%	5.0%	4.8%	4.6%
	$85.0	5.7%	5.4%	5.2%	5.0%	4.8%
	$90.0	6.0%	5.7%	5.4%	5.2%	5.0%

Tax rate vs annual cost savings

		Annual cost savings ($m)				
		$30.00	**$40.00**	**$50.00**	**$60.00**	**$70.00**
Tax rate	**25%**	6.3%	6.9%	7.5%	8.0%	8.6%
	30%	5.9%	6.4%	7.0%	7.5%	8.0%
	35%	5.5%	6.0%	6.5%	7.0%	7.5%
	38%	5.3%	5.7%	6.2%	6.7%	7.2%
	40%	5.1%	5.5%	6.0%	6.4%	6.9%

Source: Bloomberg, company reports, and IGR.

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Independent Global Research
14 Wall Street, Suite 3A
100 Wall Street, 20th Floor
Tel (UK): 44 207 570 0322
Tel (New York): 212-796-5769
www.independentglobal.com

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