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Restaurant Research Think Piece – August 2011

Dunkin' Starts Out with Imperative for Growth

The restaurant business can be difficult for highly leveraged players which have to deal with recessions and periodic expense spikes in the form of necessary R&D and facility upgrades.

As we can see from the table below, many of the major QSR players in the coffee/beverage/dessert space maintain very low leverage levels which seem reasonable given the consumer discretionary nature of the business.

Dunkin' stands out with net debt representing nearly 8x operating cash flow (OCF) although we recognize that the company's business model benefits from nearly exclusive franchisee ownership of store assets. In any case, Dunkin's plan would seemingly be to leverage its brand strength to out-grow this problem after its recent IPO. During the quarter ended 6/25/11, the company reported a 6.9% y/y increase in global comp sales (3.2% in the US) with 140 net new stores globally during the quarter (up 3.4% on an annualized basis).

In the end, an imperative for growth can represent a double-edged sword: on the one hand, it makes Dunkin' Brands a very motivated (and therefore a very dangerous) competitor, but on the other hand it raises the possibility of straining the company's operations which could drive a decline in service quality and/or poor choices for site locations. In any case, we hope for Dunkin's sake that the economy doesn't drop into a double-dip...

Leverage Comparisons						
						CAD
\$MM	Dunkin'	Starbucks	McDonald's	Krispy Kreme	Einstein Noah	Tim Hortons
Operating Cash Flow - LTM	\$218	\$1,417	\$6,472	\$24	\$39	\$393
Cash	\$146	\$1,645	\$1,940	\$25	\$11	\$313
Total Debt	\$1,861	\$549	\$11,443	\$35	\$83	\$482
Net Debt	\$1,715	(\$1,096)	\$9,504	\$10	\$72	\$168
Net Debt/OCF	7.9	nm	1.5	0.4	1.8	0.4
Financials date	6/25/2011	4/3/2011	3/31/2011	5/1/2011	3/29/2011	4/3/2011

Source: Company reports

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