MANAGEMENT DISCUSSION SECTION

Operator: Good day. And welcome to today's Krispy Kreme Q4 2009 Earnings Conference Call. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to your host, Mr. Brian Little. Please go ahead, sir.

Brian K. Little, Director, Corporate Communications

Thank you, operator. Good afternoon, all. Welcome to the Krispy Kreme 2009 fourth quarter and fiscal year-end earnings conference call. On the call for Krispy Kreme today is Jim Morgan, President and Chief Executive Officer; Doug Muir, Executive Vice President and Chief Financial Officer; and as the operator mentioned I'm Brian Little, Director of Corporate Communications for Krispy Kreme.

During the call today, Mr. Morgan will comment on the company's performance and share some thoughts about the months ahead. Mr. Muir will then give an overview of the financial results released earlier today. Following their comments, the operator will open the lines to take your questions.

Now, as a reminder. A copy of our earnings announcement is available in the News Release section under the Investor Relations tab at our website, krispykreme.com. Also, this conference call is being webcast and will be archived on our website for one year. A transcript of this conference call will also be available there. Investors, analysts, and shareholders are directed to these online public resources for the most up-to-date company information. Krispy Kreme Investor Relations can be reached via email at ir@krispykreme.com.

Our comments today should be considered forward-looking in nature and are subject to various risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or expected. Key factors that may have a direct bearing on Krispy Kreme's operating results, performance, or financial condition are discussed in Krispy Kreme's periodic reports filed with the U.S. Securities and Exchange Commission.

I'll now turn the call over to Mr. Morgan. Jim.

James H. Morgan, President and Chief Executive Officer

Thank you, Brian, and good afternoon to everyone. As I'm sure most of you, have seen our bottom-line results improved in the fourth quarter compared to both third quarter as well as compared to fourth quarter of last year. We reported an operating profit for the fourth quarter and also for the year. This is our first annual operating profit since fiscal 2004.

The strategic initiatives we put in place in the past year are showing early signs of taking hold and we are seeing the beginnings of some measurable progress towards achieving our strategic objectives. We expect that progress to continue into fiscal 2010 and beyond. The progress to date, I want to make a strong point of this, is due in large measure to the hard work and dedication of our employees.

They are the ones responsible for moving us forward and I'll make a little ad lib here. I was fortunate enough to know some of these employees before I accepted the role that I took a little over a year ago. And I want to assure you that knowing that they were here and knowing what they were capable of had an awful lot to do with my energy and enthusiasm for assuming this role and they have exceeded even my expectations in this past year.

Our ongoing commitment is to make the necessary operational and financial investments in this business in order to insure long-term stability and lay the foundation for long-term growth. Our progress toward achieving our goals will not always be smooth and we won't achieve consistent predictable earnings overnight.

But we truly believe we are headed in the right direction. I believe in our future and I believe that fiscal 2010 will be a year in which we will make additional measurable progress in improving our business. We are keenly focused on our strategic initiatives and our commitments to grow business over the long term.

We are proceeding with a greater sense of urgency than ever before and continue to purposely execute against our strategic plan. We are committed to addressing the challenges that remain as we move forward becoming a stronger more focused company. It is my genuine belief that we are in the early stages of building something special.

Today I would like to speak briefly about some of the early successes we are seeing as a result of the work our employees are doing in support of our strategic initiatives and then I will share some brief thoughts about the months to come. After that I will turn the call over to Doug.

I'm going to start with our new small retail shops. We have recently opened two new company owned small retail shops, one in Smyrna, Tennessee and the other in our hometown of Winston-Salem, North Carolina. These two shops are the first new company shop openings in over four years. We continue to secure additional real estate for suitable sites to open additional small retail shops in our company heartland.

We have domestic franchisees that are demonstrating their belief in the concept by also opening small retail locations in their markets. We believe we will see good economics from these small retail shops because of their smaller size and their inherent simplicity. Moreover, we think we can leverage the fixed cost base of existing traditional factory shops by using their existing production capacity to supply the new small shops.

Even more important is the additional convenience for consumers made possible by these smaller shops. For years, consumers have told us we need to be more convenient and the new smaller stores will enable us to provide the Krispy Kreme value and experience to more and more new guests as well as to existing guests more frequently. Finally, having greater store density in our market should make possible a higher level of advertising spending and should enable us to make increased use of broadcast media. We view this as very important to our long-term growth.

On the product side, each of our new company owned small shops will include our Kool Kreme platform and we plan to add this platform to existing stores in our expansion markets as well. Just to remind you, Kool Kreme is a truly delightful soft serve product with a variety of accompanying toppings and it's a great complimentary day part and seasonal part product for our traditional doughnut products and therefore has the potential to provide significant operational leverage. We are excited about expanding our Kool Kreme testing this year.

As for shop operations, consistently executing the QSR basics and offering an outstanding consumer experience at all of our shops remains a key part of our strategic initiatives and we have made progress there as well.

In the second half of last year we stepped up the store facelift work to improve our consumer appeal. Employee training and development have been significantly expanded to further equip our employees to offer a superior consumer experience and to improve shop profitability.

We are also devoting resources to deepening our bench to support future store growth. We strongly believe that these investments in our stores and in human resources are critical to our becoming a best-in-class QSR operator, a goal to which we are deeply committed.

As far as organizational changes are concerned, we have begun reorganizing and streamlining our own premises' and all premises' reporting structure with the intent of establishing clear lines of authority, responsibility, and accountability for results in both these distribution channels. We have also introduced a new sales-focused compensation plan that incentivizes our all-premises sales force to grow the business and allows them to share in the economics of that growth.

It is too early to assess the full effects of these changes, but early results are very encouraging. As to our franchisees, we have an increasingly collaborative relationship with our franchisees. Our franchisees are putting in a lot of effort to make Krispy Kreme successful in their markets and there's much that we can learn from them and from each other.

We are committed to providing an enhanced level of marketing and operational support to our franchisees around the world. We are also providing increased supply chain support to our global business and working to improve franchisee service levels domestically and abroad.

Internationally, the international section continues to be very important to us. Our measured international growth continues and as we take the steps required to absorb and build on our previous successes in international markets. International franchisees' enthusiasm for the brand motivated them to accelerate their store development calendars and they opened 114 new shops last year. That was a great performance but we don't expect international franchisees to open that many stores this year.

We do however continue to believe that international growth opportunities will keep us busy for many years to come. Krispy Kreme stores are scheduled to open in China, Malaysia, and Turkey during the 2009 calendar year. One thing that we do expect will adversely affect us in 2010 is the stronger U.S. dollar compared to fiscal 2009. A strong dollar does hurt our international franchise revenues because local currency sales translate into fewer U.S. dollar royalties.

We are committed to growing on international markets, while providing the necessary infrastructure support that are new and existing franchisees need to assist them in being successful. As I said in the beginning of these comments, the strategic initiatives we instituted during calendar year 2008 are beginning to show early signs of progress. And what I just summarized to you are some of those signs.

In summary of my overall comments, let me just share with you what we expect over the next 12 to 14 months. I'm going to itemize six or seven specifics here. First, we expect to see several new company small shops up and running, as we continue to pursue our small store concept with the complimentary Kool Kreme platform.

Second, we expect continued domestic shop operational improvements, including a constantly improving in-store guest experience. Third, we anticipate improved economics in the off-premises distribution channel, as a result of stringent cost controls, lower commodity costs, more efficient operations, stronger marketing efforts, and greater emphasis on longer shelf-life products.

Fourth, we anticipate a stronger domestic and international franchise network as a result of the franchisees' intense focus, local marketing initiatives, and our renewed commitment to enhanced operational support, supply chain economics, and overall service.

Fifth, we will continue testing the new product concepts, including Kool Kreme and baked goods, and these are designed to broaden our offerings and help address both our day part and our seasonal part challenges.

And sixth, we expect a continuation of our measured international growth.

In conclusion, let me state once more that we have been consistently executing against our strategic initiatives. We've had some wins and there are signs of more wins. We are on a very exciting journey and I am truly confident that sustainable, profitable growth is achievable. We will continue to encounter obstacles along the way and there's still much work to do. But we will overcome our challenges and over time steadily improve our performance. Among the results should be a highly motivated and positive employee base, an extraordinary guest experience at Krispy Kreme stores, a network of highly successful franchisees, and shareholders who have been well rewarded for their patience.

I'll now turn the call over to Doug.

Douglas R. Muir, Executive Vice President and Chief Financial Officer

Thank you, Jim, and good afternoon, everyone. We issued our fiscal 2009 fourth quarter and year-end earnings release this morning. As you review the numbers in the tables and compare them to last year, please remember that fiscal 2008 was a 53-week year and last year's fourth quarter had 14 weeks.

During the fourth quarter, franchisees opened 24 new Krispy Kreme stores system wide, most of which were small retail concepts opened by international franchisees. That brought the number of stores opened internationally for the year to 114, which significantly exceeded our expectations as international franchisees continued to open stores ahead of their development schedules.

That number of openings was, as Jim said, a great performance, but you should not expect that 100 or more international store openings is the annual run rate, at least not in the short term. But we remain very excited about our international growth prospects, not only for next year but for the long term.

We have been talking for a long time about international growth. We and our franchisees are now moving forward to open small retail concept shops here in the U.S. On March 31 and April 9, we opened the company's first two new small retail concept stores, one here in Winston-Salem and the other in Smyrna, Tennessee, outside Nashville. Both are end-cap locations with drive-throughs, which is our most desired shop configuration.

In addition to these two locations, we are actively negotiating a number of additional sites in about a half a dozen different markets. Our domestic franchisees also are continuing to move forward with their own plans for small retail concepts. In the fourth quarter, a franchisee hot shop opened in Commerce, Georgia and our franchisee in Mesa, Arizona opened its fourth satellite store just after the end of the year. All four satellites in Mesa are being supplied by a single traditional factory store.

There's a lot of interest in the franchise community about small stores and we expect there will be some additional domestic franchisee openings in the months ahead.

Turning now to results for the quarter. We reported a net loss of $303,000 or less than a penny a share in the fourth quarter of fiscal 2009 compared to a net loss of about 32 million or $0.50 a share in the fourth quarter last year. We posted an operating income of 1.5 million in the fourth quarter this year compared to an operating loss of 25 million in the fourth quarter last year.

Last year's fourth quarter included some impairment and lease termination charges of about 28 million, most of which were non-cash and related to the company store segment. We only had 1.2

million of such charges in the fourth quarter this year. Operating income in the fourth quarter last year also reflected a charge of 2.7 million related to the resignation of a former executive.

There are two non-operating items to take note of. These were again below operating income in the non-operating income and expense caption. In the fourth quarter last year, we recorded a charge of $3 million for estimated payments under certain guarantees of franchisee financial obligations. In this year's fourth quarter we reported a non-cash gain of 2.8 million related to our re-franchising of our four stores in Canada.

There continues to be some good news on the cost front. Recent economic conditions resulted in significant reductions in the prices of agricultural commodities in the fourth quarter. And those reductions have continued and in some cases increased into the first quarter of fiscal 2010. These reductions have lowered KK supply chain's costs and enabled the supply chain to reduce prices charged to company stores and franchisees, most notably for doughnut mix and shortening. These price reductions benefited us in the fourth quarter and are expected to continue to benefit us for the remainder of fiscal 2010.

The decline in gasoline prices also resulted in significantly decreased costs in the fourth quarter. Although gas prices have recently started to rise a bit, we expect to see a benefit from lower fuel costs in fiscal 2010 compared to fiscal 2009. We're also continuing to take steps to better manage our distribution costs and, as Jim said, to put in place incentive plans that incentivize revenue growth.

I'd like to take just a few moments to speak to our financial position. We ended fiscal 2009 with net debt. Net debt meaning, total debt minus cash of 39 million. That is 32 million dollars less debt than we had two years ago. At year end we were in compliance with the financial covenants contained in our secured credit facilities. As we previously disclosed, those covenants were scheduled to become more stringent in fiscal 2010. Yesterday, we completed an amendment to those credit facilities which, among other things, relaxed the interest coverage ratio covenant through fiscal 2012. Based on our current working capital and our fiscal 2010 operating plan, we believe we can comply with the amended financial covenants and that we can meet our projected operating, investing, and financing cash requirements.

Let me take just a minute to review the other principle features of the amendment to the credit facilities. First, we agreed to raise the rate of interest on the facilities by 200 basis points annually. Second, we reduced the amount of the revolving credit facility from 30 million to 25 million. You'll recall that the revolver has been used solely to support undrawn letters of credit, principally related to self-insurance obligations. Those letters of credit total about 16 million, leaving 9 million of unused revolver borrowing capacity even after the size reduction. Third, we paid lenders – or excuse me, we paid fees to the lenders and the arrangers of about $2 million. Finally, we prepaid 20 million of the outstanding term loan balance. That prepayment reduced the outstanding loan balance from 74 million to 54 million.

Now a word about liquidity. Cash on the balance sheet rose by $2 million in February and March to 39 million as of the end of our March month end. On a pro forma basis, giving effect to the 20 million debt pay down and the related fees, cash at the end of March was 17 million, still a very healthy number. In addition, as I mentioned a moment ago, there is also $9 million of unused borrowing capacity on our revolving credit facility.

Looking ahead, we expect to benefit significantly this coming year from lower costs of ingredients and from lower gasoline costs. As Jim mentioned, we also expect to see improved results in our shops from operational improvements and from increased focus on the off-premises distribution channel. On the other hand, we have weak economic conditions domestically and economic weakness also is apparent to a greater or lesser extent in international franchise markets. The uncertainties associated with a weak global economy have resulted in a stronger U.S. dollar, which adversely affects our international royalty revenues. A very uncertain economy makes revenue forecasting particularly challenging.

One thing we find encouraging is that our company-owned same-store sales comps improved in Q4 over Q3 and improved sequentially each month during the fourth quarter. But given the uncertainties, we have attempted to plan and budget conservatively for the coming year. Having said that, looking at numbers for the first two months of fiscal 2010, we feel today that we are off to a good start.

Operator, we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]. And our first call will come from Buzz Zaino from Royce & Associates.

<Q – Boniface Zaino>: Good afternoon. In prior calls you referenced the franchisees in danger of bankruptcy and/or closing stores. You didn't seem to mention those in this release. What is the status of the franchise group today?

<A – Douglas Muir>: This is Doug. I think as we look in the year ahead we think there will be probably a fair number more franchisee openings than closings next year. There'll undoubtedly be some closings, we'll probably have a few and the franchisees will probably have a few. On balance, I think our franchisees are stronger today than they were a year ago. But it is an uncertain economy. Said before, some of our franchisees have a fair amount of leverage and there are risks associated, but on balance, I think we're satisfied with where our franchisees are domestically and we think they're moving in the right direction.

<Q – Boniface Zaino>: True. Just following that, what's been the bad debt experience recently, last quarter?

<A – Douglas Muir>: I don't happen to have a fourth quarter number. I can give you a number for the year. It is in the cash flow statement. Let me just dig it out here. All in, total bad debt expense was about 300,000 last year. In fairness, there were some one-time credits from some recoveries and some reduced exposure to some franchisees in last year's number. The number for the preceding year, that's the January '08 year, was about 1.8 million. Taking the one-off items out of this year's number, even bad debts were down this year compared to the 1.8 million that we saw in fiscal 2008.

<Q – Boniface Zaino>: Great. You mentioned in the release something about a tunnel oven technology. Would you reference that and tell us what that is?

<A – Douglas Muir>: Jim, would you like to do that one or...

<A – James Morgan>: Go right ahead.

<A – Douglas Muir>: Tunnel oven is a technology and a piece of equipment that we have been testing for a number of years. The basic concept is to enable us to put the signature hot doughnut product closer to consumers and to be able to offer it around the clock and not have to be running a big traditional production line. So the tunnel oven is basically a small production and finishing facility and equipment that takes doughnuts that are supplied from a nearby factory store, a traditional factory store, and enables us to do the finishing process, including making the hot doughnut and the glazing process in the store and in a very small footprint, compared to a traditional factory store. There's a number of them in operation throughout the world and it's something I think we'll see more of introduced in the U.S. this year.

<Q – Boniface Zaino>: Are they going into the small retail store?

<A – Douglas Muir>: They are. They are going into some of the small retail concepts. I should add that they are also going into some of the traditional factory stores. For example, the store that we opened in Winston-Salem at the end of March is a traditional factory store in that it has a full-blown Krispy Kreme production line in it, but it's a 65 dozen an hour line which is smaller capacity than what you see in the older Krispy Kreme stores.

We have also put a tunnel oven in that store. And it's a great opportunity for basically that store to be its own hub and produce its own doughnuts for use in the glazing and finishing process. We also have a store in Nashville and some others in the system that have paired the tunnel oven with the traditional factory store line.

<Q – Boniface Zaino>: Thanks very much.

Operator: [Operator Instructions]. We have no further questions at this time.

Brian K. Little, Director, Corporate Communications

Thank you, operator. With no further questions I would like to remind everyone that this webcast conference call has been archived or will be archived and available on our website. There will also be an archived telephone replay available following the conclusion of our call. You will find the dial-in numbers and access pass code in our earnings release. Thank you for joining us and have a good evening.

Operator: Ladies and gentlemen, that does conclude today's conference. We thank you for your participation and have a great day.