

Strapped for Cash: Mitigating CKE's Debt Burden

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Executive Summary

In this engagement we examine CKE's expansion plans and recommend some changes in strategy. In the summer of 1997 CKE acquired the Santa Barbara Restaurant Group which added Hardee's, La Salsa, and The Green Burrito to the successful Carl's Jr. fast food chain. The purchase allowed CKE to expand its fast food model on a nationwide scale through the former number-four burger chain Hardee's. However, CKE took on large amounts of debt to finance the acquisition. Continued weakening of sales at Hardee's has lowered profits, and revenue growth in Carl's Jr. has not proven sufficient to offset the losses. The upshot is that CKE purchased a project for turnaround, but today the company lacks ample funds to carry out its plans.

Intense price competition from the top two fast food burger chains, McDonald's and Burger King, has also forced CKE to exit the discount burger arena and to reposition its product line with a focus on producing a premium product with high profit margins. At the same time, CKE has directed resources to renovate and rebrand Hardee's to follow the successful Carl's Jr. model. The rollout of the new menu and the restructuring of Hardee's has required CKE to borrow large quantities of money. The increasing hesitance of investors to buy CKE bonds because of the default risk in such a competitive industry adds to the problem.

In hindsight, CKE has taken on too much too fast. Blaisdell Consulting recommends that CKE first concentrate on paying down its large debt in order to reduce high leverage. To accomplish this, Blaisdell Consulting recommends the following strategies:

- ?? Sell company-owned stores to franchisees and close under funded stores. Proceeds from the sale of company stores and closure of underperforming stores will allow CKE to reduce leverage without sacrificing quality of service.
- ?? Implement an efficient and cost-effective but downsized marketing campaign. CKE has launched an aggressive advertising campaign informing the public of the "Thickburger" menu and the facelift performed on Hardee's. While sales have improved as a result, CKE should reduce spending on marketing in the short run to free up cash.
- ?? Secure a short-term credit facility to finance maturing bonds and continue operations. Due to pressure exerted on CKE by maturing bonds and operations expenses, CKE may need to borrow money in order to stay afloat. While this method is temporary, it will allow CKE more time to implement strategies to reduce the debt load.

CKE has positioned the Hardee's and Carl's Jr. concepts for success for the coming decades by building their menus around high-profit premium "Thickburgers." This is a good strategy, but CKE needs to slow down and get its financial house in order. The company cannot lose sight of its short-term financial woes. By adhering to the strategies laid out by Blaisdell Consulting, CKE will be able to pay off debt and free up cash for future investment opportunities. This can be followed by its repositioning plans in the marketplace.



Company Overview

CKE Restaurants, Inc. owns, operates and franchises quick-service restaurants (QSR), primarily under the brand names Carl's Jr. and Hardee's. Carl's Jr. restaurants are located predominately in the western U.S. while Hardee's restaurants are located primarily in the mid-western and south-eastern U.S. The company's system-wide restaurant portfolio at April 8, 2003 consisted of 440 company-operated and 547 franchised and licensed Carl's Jr. restaurants and 730 company-operated and 1,499 franchised and licensed Hardee's restaurants. The company also has investments in other restaurant brands such as La Salsa with 57 company-operated and 42 franchised and The Green Burrito with 5 company-owned, 28 franchised, and 200 dual-branded restaurants with Carl's Jr. Outside of these core concepts, CKE also owns a stake in the Timber Lodge Steakhouse chain, Boston Market, Checkers Drive-In, and Rally's, among others. Overall, the CKE Restaurant network spans over 45 states and 15 foreign countries with over 3,400 locations and employs a workforce of approximately 33,200.

History

CKE Restaurants was founded in 1941 by Carl Karcher when he purchased a hot dog stand for \$311. Four years later, Karcher opened his first full-service restaurant, Carl's Drive-In Barbeque, in Anaheim, California. A year later, hamburgers were added to the menu. Business boomed and Carl Karcher Enterprises, as the company become known, opened its 100th restaurant in 1974. CKE went public in 1981.

In the early 90's, Carl's Jr. experienced falling sales and Karcher was voted out as chairman. William Foley, an insurance executive, bought 25% of the company and installed himself as chairman. During his tenure, CKE acquired Summit Family Restaurants (operator of Hometown Buffet, JB's, and Galaxy Diner) and quickly divested in the acquisition to focus on quick-service restaurants. CKE also took over the bankrupt Boston Chicken chain in Southern California.

In July of 1997, CKE purchased the fourth largest fast-food burger chain, Hardee's, from the Santa Barbara Restaurant Group as a turnaround opportunity. Foley was replaced as CEO in 2001 and Hardee's CEO Andrew Puzder has taken the reins of the company since then. On March 1, 2002 the company acquired the rest of the Santa Barbara Restaurant Group and its La Salsa, Green Burrito and Timber Lodge Steakhouse restaurant brands. La Salsa and The Green Burrito extend CKE Restaurant's focus on premium products into Mexican quick-service restaurants featuring traditional Mexican food items including burritos, tostadas, enchiladas, tacos, gorditas, chile rellenos, tortilla soup, appetizers and non-alcoholic Mexican drinks. Timber Lodge Steakhouse restaurants offer traditional American meals at moderate prices in the Midwest.



Financial Overview

Capital Valuation

CKE Restaurants (ticket symbol: CKR) closed at \$5.36 on April 8, 2003, closing up \$2.35 from its 52-week low three months earlier. However, CKR is trading at less than fifty percent of its 52-week high. The present market capitalization for CKE is \$307.1 million, based upon 57.3 million shares outstanding.

Table 1 represents the shares outstanding, closing price and market capitalization at the end of CKE's fiscal year over the past 5 years along with the present stock price. Chart 1 represents CKE's stock price performance during the past 5 years compared to the S&P 500 and the company's main competitors in the quick-serve burger industry, McDonald's (MCD) and Burger King (DEO).

Table 1

Fiscal Year	Shares Outstanding	Close	Market Cap	% Change
1998	51.9M	22.30	1157.4M	
1999	52.1M	6.44	335.5M	-71.0
2000	52.1M	3.08	160.5M	-52.2
2001	50.6M	9.90	500.9M	212.2
2002	57.3M	3.53	202.3M	-59.6
April 8, 2003	57.3M	5.36	307.1M	51.8

From 1995 until the beginning of 1998, CKE's stock price had increased almost fourfold from \$4 to \$40, with market capitalization peaking at over \$2 billion dollars. The acquisition of Hardee's from the Santa Barbara Restaurant Group in the summer of 1997 was followed by continued growth in the stock price until it started slipping in 1998. During FY 1999, CKE experienced tremendous losses as its stock price tumbled from \$22.63 to \$6.44, translating into a 71% drop in market capitalization from just over \$1.16 billion to \$336 million. The downward trend persisted through FY 2000 as CKE continued to experience losses from the acquisition of the Hardee's concept and the downturn in the economy. As a result, market capitalization fell an additional 53%, from \$336 to \$161 billion.

Mainly due to the CEO change from Foley to Puzder, CKE regained some of the lost market cap in FY 2001, increasing more than threefold from the previous year. FY 2002 with Puzder at the helm resulted in large losses resulting from a general downturn in the QSR industry and continued restructuring of the Hardee's concept. Since the beginning of FY 2003, however, because restructuring of the Hardee's brand is almost complete, CKE's market capitalization has rebounded 52% to \$271 million and financial health of the company has been improving.



Chart 1

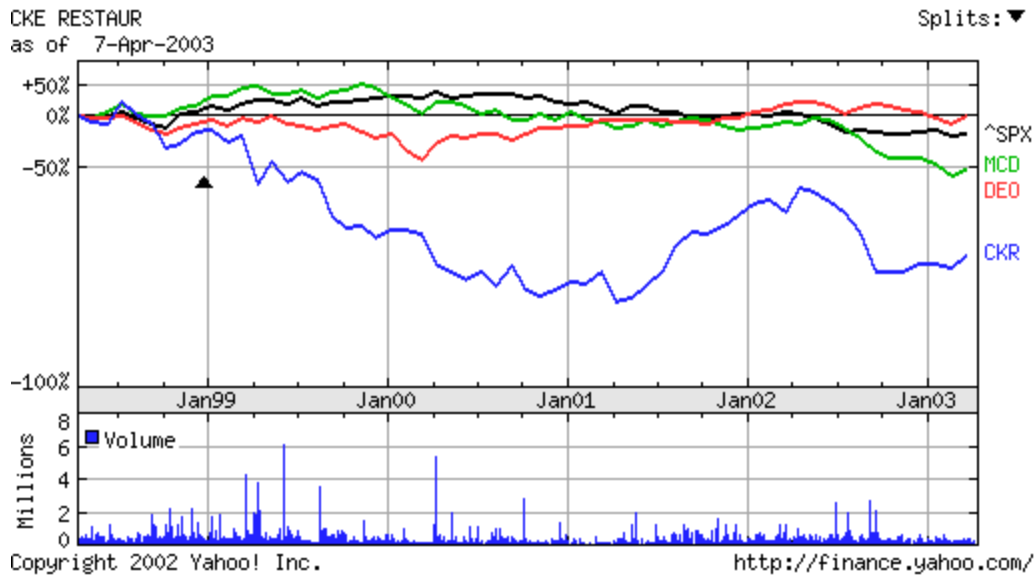


Chart 1 depicts the performance of CKE’s stock compared with its major rivals, McDonald’s and Burger King, and the S&P 500. For the greater portion of 1998, CKE’s stock performance matched industry rivals and the S&P. However, while McDonald’s and Burger King have moved in line with the S&P for the past 5 years, CKE has diverged further into negative territory.

Table 2

Current Broker Recommendations				
Strong Buy	Buy	Hold	Sell	Strong Sell
1	1	2	0	0

Table 2 shows the current broker recommendations for CKE stock. From the four brokers covering CKE, there are still mixed feelings as to where the stock might be heading. CKE has made drastic changes over the recent months by completely overhauling the Hardee’s menu and implementing the new menu centered on the “Thickburger” line. Also, the implementation of the Carl’s Jr. business model in the existing Hardee’s chain may alienate existing customers and pose operational difficulties in the future. Until more definitive progress is made at Hardee’s, most investors will be waiting on the sidelines.



Financial Statement Analysis

Detailed Annual Financials

All dollar amounts in millions except per share amounts.

Income Statement	Jan 03	Jan 02	Jan 01	Jan 00	Jan 99
Revenue	1363.4	1438.1	1784.6	1990.1	1892.0
Cost of Goods Sold	698.6	749.8	905.9	960.3	1422.6
Gross Profit	664.8	688.3	878.7	1029.8	469.4
Gross Profit Margin	48.8%	47.9%	49.2%	51.7%	24.8%
SG&A Expense	545.2	566.7	760.1	835.5	224.1
Depreciation & Amortization	71.1	76.6	107.0	104.5	77.1
Operating Income	48.5	45.0	11.6	89.8	168.2
Operating Margin	3.6%	3.1%	0.7%	4.5%	8.9%
Nonoperating Income	15.8	(0.6)	(48.8)	(32.0)	(0.7)
Nonoperating Expenses	42.7	57.7	69.8	63.3	43.5
Income Before Taxes	18.4	(84.7)	(205.3)	(47.5)	124.0
Income Taxes	(7.4)	(0.6)	(11.1)	(18.1)	49.6
Net Income After Taxes	25.8	(84.1)	(194.2)	(29.4)	74.4
Total Operations	25.7	(84.0)	(194.1)	(29.4)	74.5
Total Net Income	(150.1)	(84.0)	(194.1)	(29.1)	77.8
Net Profit Margin	--	--	--	--	4.1%
Balance Sheet	Jan 03	Jan 02	Jan 01	Jan 00	Jan 99
Cash	18.4	24.6	16.9	36.5	40.3
Net Receivables	45.7	44.3	76.5	47.9	48.3
Inventories	19.2	17.4	17.7	26.5	22.5
Other Current Assets	39.0	10.0	79.7	17.2	23.2
Total Current Assets	122.4	96.4	190.7	128.1	134.3
Net Fixed Assets	612.3	607.0	774.3	1136.0	1022.1
Other Noncurrent Assets	108.8	228.2	249.0	304.5	340.5
Total Assets	843.5	931.6	1214.0	1568.5	1496.9
Accounts Payable	57.0	47.4	53.8	99.2	88.5
Short-Term Debt	34.8	10.3	77.2	15.1	12.1
Other Current Liabilities	102.1	91.2	83.0	97.6	101.1
Total Current Liabilities	193.8	148.8	214.0	211.9	201.6
Long-Term Debt	384.8	429.3	547.2	726.3	613.3
Other Noncurrent Liabilities	71.3	91.8	103.3	84.6	80.1
Total Liabilities	650.0	670.0	864.5	1022.8	910.1
Common Stock Equity	193.6	261.7	349.6	545.8	586.8
Total Equity	193.6	261.7	349.6	545.8	586.8
Cash Flow Statement	Jan 03	Jan 02	Jan 01	Jan 00	Jan 99
Net Operating Cash Flow	62.3	71.5	28.3	114.6	172.7
Net Investing Cash Flow	(43.0)	116.1	75.0	(216.2)	(499.7)
Net Financing Cash Flow	(25.5)	(179.8)	(123.0)	91.8	337.2
Net Change in Cash	(6.2)	7.8	(19.6)	(9.8)	10.1



Income Statement

Revenues nearly doubled in FY 1998 to 1.15B after the acquisition of Hardee's in July 1997 and continued growing until revenues peaked during FY 1999 at 1.99B. Since then, revenues have been decreasing at an average rate of \$200M which reflects systemwide store closures and a decrease in sales. Gross profit margins and operating margins, on the other hand, have shown signs of improvement over the past two fiscal years. The main contributor to the rebounding of profitability margins is the restructuring of Hardee's and the introduction of products with higher premiums and developing synergies between Hardee's and Carl's Jr. systems.

Balance Sheet

Over the past five years, CKE's total assets have declined by almost 50%. This drop was led by changes in net fixed assets and other noncurrent assets potentially related to store closures and the selling of company owned stores to franchisees. Cash-on-hand has declined from a five year high in FY 1998 of \$40.3M to \$18.4M currently. Net receivables and inventories have changed marginally.

On the liabilities side, while current liabilities have remained almost unchanged over the past five years, CKE has managed to reduce long-term debt from \$726.3M to \$384.8M.

Cash Flow Statement

From the cash flow statement, we can see that CKE devoted some of the cash generated from operating activities to increasing productive capacity while the rest of the cash was used to pay down debt from financing activities.



Key Financial Ratios

Relative Valuations	Last 12 Months	3-Year Average	5-Year Average
P/E Ratio	12.8	N/A	N/A
Price/Revenue	0.24	0.2	0.28
Price/Cash Flow	3.3	-23.5	-11.6
Price/Free Cash Flow	-17.6	-1.1	-1.8
Price/Book Value	1.67	1.14	1.22
Price/Tangible Book	2.36	3.09	2.81
Book Value Per Share	3.38	5.09	7.41

Financial Strength

Current Ratio	0.6	0.7	0.7
Quick Ratio	0.3	0.4	0.4
Debt/Equity	1.99	1.69	1.39
Total Debt to Equity	2.17	1.84	1.47
Total Capital	578,411,000	722,034,667	927,649,000
Debt/Total Capital	0.67	0.63	0.58
Interest Coverage from Continuing Operations	1.4	N/A	0.3
LT Debt as pct. of Invested Capital	66.5%	62.8%	58.2%

Profitability

Pre-Tax Profit Margin	1.3%	-5.9%	-2.3%
Post-Tax Profit Margin	1.9%	-5.5%	-2.4%
Net Profit Margin	1.9%	-5.5%	-2.4%
EBIT Margin	4.5%	-2.2%	1%
EBITDA Margin	8.8%	7.8%	9.4%
Gross Margin	48.8%	48.7%	44.1%
Effective Tax Rate	N/A	N/A	N/A

Effectiveness and Efficiency

Total Return	-54.5968%	-3.4894%	-83.2712%
Return on Equity	13.3%	N/A	N/A
Return on Assets	3.1%	-8.4%	-3.4%
Return on Invested Capital	4.5%	-11.6%	-4.5%
Revenue/Employee	45,447	47,369	40,594
Net Income/Employee	860	-2,439	-1,337
Asset Turnover	1.5	1.4	1.4
Receivables Turnover	30.3	27.6	34.7
Inventory Turnover	38.2	40.7	46.6
Inventory as pct. of Revenue	1.4%	1.2%	1.2%
Cost of Goods Sold as pct. of Revenue	51.2%	51.3%	55.9%





Competitive Landscape

Key Numbers	CKE Restaurants	McDonald's	Wendy's	
Annual Sales (\$mil.)	1,363.4	15,405.7	2,730.3	
Employees	30,000	413,000	48,000	
Market Value (\$mil.)	322.9	20,313.6	3,285.9	
Profitability	CKE Restaurants	McDonald's	Wendy's	Industry ²
Gross Profit Margin	48.76%	57.04%	28.29%	39.03%
Pre-Tax Profit Margin	1.35%	10.79%	12.67%	8.61%
Net Profit Margin	1.89%	6.44%	8.01%	5.41%
Return on Equity	13.3%	9.6%	15.1%	14.6%
Return on Assets	3.1%	4.1%	8.2%	6.3%
Return on Invested Capital	4.5%	5.0%	10.3%	8.3%
Valuation	CKE Restaurants	McDonald's	Wendy's	Industry ²
Price/Sales Ratio	0.24	1.32	1.20	0.95
Price/Earnings Ratio	12.80	20.79	15.16	18.25
Price/Book Ratio	1.67	1.98	2.27	2.57
Price/Cash Flow Ratio	3.33	9.94	9.10	9.35
Operations	CKE Restaurants	McDonald's	Wendy's	Industry ²
Days of Sales Outstanding	12.07	19.99	12.87	11.83
Inventory Turnover	38.2	60.9	52.3	30.0
Days Cost of Goods Sold in Inventory	9	6	7	12
Asset Turnover	1.5	0.7	1.2	1.2
Net Receivables Turnover Flow	30.3	17.7	28.4	30.7
Effective Tax Rate	--	40.3%	36.7%	36.1%
Financial	CKE Restaurants	McDonald's	Wendy's	Industry ²
Current Ratio	0.63	0.71	0.92	0.72
Quick Ratio	0.3	0.5	0.7	0.4
Leverage Ratio	4.36	2.33	1.84	2.33
Total Debt/Equity	2.17	0.97	0.47	0.81
Interest Coverage	1.4	5.4	9.3	6.3
Per Share Data (\$)	CKE Restaurants	McDonald's	Wendy's	Industry ²
Revenue Per Share	23.77	12.14	23.81	20.16
Fully Diluted Earnings Per Share from Total Operations	0.44	0.77	1.89	1.05
Dividends Per Share	0.00	0.24	0.18	0.11
Cash Flow Per Share	1.69	1.61	3.15	2.05
Working Capital Per Share	(1.25)	(0.56)	(0.26)	(0.82)
Long-Term Debt Per Share	6.71	7.65	5.94	5.74
Book Value Per Share	3.38	8.10	12.63	7.46
Total Assets Per Share	14.71	18.89	23.26	17.40



Ratio Analysis

Compared to the industry leader McDonald's, CKE Restaurants is almost fifteen times smaller in terms of annual sales and employees. However, McDonald's market capitalization of \$20.3B is more than 60 times CKE's market cap of \$322M. When paired up with Wendy's, a successful competitor of similar size, CKE's sales per employee is lower and market capitalization is 10 times smaller. These key numbers clearly display CKE's inefficiencies and the market's beliefs of CKE's future.

In almost every category, CKE significantly trails both McDonald's and well-managed Wendy's. CKE's net profit margin of 1.89% is overshadowed by profit margins three to four times higher posted by CKE's main competitors. In response, CEO Andy Pudzer has focused on raising profit margins by redesigning the menu around higher-margin, premium "Thickburgers" such as the successful Six Dollar Burger. Also, a recent improvement in return on assets reflects more effective allocation and management of resources from owners and creditors. However, CKE needs to continue to roll out products with higher profit margins and increase volume of sales to become a leader in profitability.

CKE's operations are much less efficient than that of the industry leaders, but the inefficiencies can be attributed to the ailing Hardee's brand. While CKE leads in asset turnover, Wendy's and McDonald's dominate in inventory turnover. In the fast food industry where the business culture focuses on low prices and high volume, inventory turnover for CKE should be much higher. To increase this figure, CKE hopes that the new menu will increase the cost of goods sold and reduce ending inventory.

The most important red flag when reviewing CKE's financials lies in the financial leverage of the company. In 1997, CKE borrowed a sizeable amount of money to acquire Hardee's, The Green Burrito, and La Salsa. Although CKE has been diverting funds to pay off debt, its debt to equity and leverage ratios are dangerously high. In addition to this, the current ratio is extremely low which shows that CKE cannot reduce current assets for cash to meet maturing obligations. CKE must rely on operating income and/or outside financing to pay off debt.

CKE cannot safely use more financial leverage due to the high unpredictability and intense competition in the industry. In order to ensure CKE's survival in future periods and boost investor confidence, Blaisdell Consulting recommends CKE to implement a strategy that will reduce the leverage ratio to a reasonable level.



Porter's Five Forces Analysis

Summary of Five Forces Analysis in the Restaurant Industry

Force	Threats to Profit
Internal Rivalry	High
Entry	Low
Substitutes and Complements	High
Supplier Power	Low
Buyer Power	Low

Internal Rivalry

CKE Restaurants competes in the saturated restaurant industry, concentrating on quick-serve stores with an emphasis on producing high-quality, high-value food products. Its core concepts are concentrated in the QSR burger/sandwich sector under the brands Carl's Jr. and Hardee's. CKE has also diversified its portfolio by acquiring the Santa Barbara Restaurant Group. The acquisition of the Santa Barbara Restaurant Group in 1997 expanded CKE's presence into quick-serve Mexican food sector with the brands The Green Burrito and La Salsa. CKE's Standard Industrial Classification (SIC) number is located under the code 5812. Its main competitors are the quick-service restaurant chains that serve burgers and Mexican foods on a large scale.

Top 10 Fast-Food Burger Brands (2000)

Rank	Brand	Market Share
1	McDonald's	43.1
2	Burger King	21.1
3	Wendy's	12.7
4	Hardee's	5.3
5	Jack in the Box	4.4
6	Sonic Drive-Ins	4
7	Carl's Jr.	2.1
8	Whataburger	1.4
9	Steak n Shake	1.1
10	White Castle	1.1

Source: AdAge.com



Internal rivalry in the quick-service restaurant industry is very high. McDonald's is the dominant player in the game having captured 43.1% of the market followed by Burger King with 21%. The four and eight firm concentration ratios in this industry are 82.2 and 94.1 percent respectively. From this, we can infer that while the industry is dominated by a few major chains, an extremely competitive fringe exists. The combination of the Hardee's and Carl's Jr. brands only account for 7.4 percent of total market share—significantly smaller than that of the number three player Wendy's.

There is little room for store-related growth in an already saturated industry and pricing pressure applied from cost leaders McDonald's and Burger King is capturing market share and hurting restaurant operations on all levels. To remain competitive in an industry with low brand loyalty and weakening profit margins, firms must exploit their competitive advantages or expand through horizontal mergers and acquisitions. Over the past five years, CKE Restaurants has implemented both strategies by establishing nationwide presence with the purchase of Hardee's and is nearing completion of effectively separating Hardee's and Carl's Jr. from the discount burger leaders by focusing on premium products with higher profit margins.

The introduction of dollar menus has intensified internal rivalry among quick-service restaurants with no endgame in sight. In addition to aggressive pricing, restaurants are rapidly expanding into non-traditional outlets such as airports, stadiums, schools, superstores, and even gas stations. In order to be successful in such a competitive industry, restaurants must strive to lower costs and/or focus on product differentiation.

Entry

In the already saturated food industry, barriers to becoming a national fast food chain are extremely high. Fast food market entrants incur high start-up costs from infrastructure creation and the establishment of physical restaurant locations on a nationwide level. Advertising campaigns involved in brand making that is necessary to attract customers also requires a considerable amount of capital. However, intense pricing competition and low customer loyalty make advertising campaigns less expensive and a smaller barrier to entry compared to other consumer-based industries.

Entrants and existing fast-food restaurants face stiff price competition, which is the main barrier to entry. The largest fast food chains, McDonalds and Burger King, operate as economies of scale and enjoy significant cost advantages over their competitors. In order to compete with large nationwide chains, the entrant must capture a sizeable amount of market share to reach a minimum efficient scale or face the prospect of being forced out in the early stages as a result of price competition. For example, McDonalds rolled out the dollar menu in an attempt to increase market share and reduce the number of players in the industry. Burger King was able to respond by creating their own budget menu while the other players were not able to compete in the price war and suffered from a loss in market share. For the hungry consumer on a shoestring budget, as the majority of fast food customers are, chains with significant cost advantages will be more



appealing. Because of the presence of many fast food chains in the industry with distinguished cost leaders and an extremely competitive fringe, potential entrants face very high barriers.

Also preventing entrants from threatening established incumbents is the lack of prime locations. In a competitive and saturated industry, prime locations have already been secured. In this respect, first movers are given a significant advantage while the rest of the players purchase and develop on the remaining locations. By the time new entrants consider competing in a specific region, locations are few and those that remain command high price tags. Because of space constraints, more developed fast food regions have little or no room for additional competitors, thus preventing entry.

Substitutes and Complements

In a well developed, mature restaurant industry, there is a wide range of substitutes to fast food dining. Restaurants have effectively entered the market at virtually every price point and diversification methods such as catering to international tastes, people with time constraints, location, and even dining purpose. A combination of all of these factors makes dining possibilities endless from buying a hot dog from a corner vendor to dining in the most luxurious restaurant.

Recently, CKE has made major efforts to carve out its own niche in fast food by developing a menu based on premium products much like In-n-Out on the West Coast. In-n-Out has proven that a fast food business model with an extremely limited menu but quality products can be successful. CKE has taken this model a step further by expanding it on a nationwide level.

The closest substitutes to the fast food industry are dining establishments located in the under \$10 a meal category. Even with this upper limit, many options are still available. CKE is striving to fill the gap between typical discount burger joints like McDonald's and reasonably priced, casual "neighborhood grills" like Applebee's. In essence, CKE is looking to reposition its Carl's Jr. and Hardee's concepts to cater to people who prefer better quality food than discount burger joints but also don't want to spend the extra money and time in an entry-level sit-down restaurant.

Complements are already included in the nature of the restaurant industry. Burgers, fries, soft drinks, and other products sold by fast food chains complement each other well. However, from another perspective, fast food restaurants sometimes complement certain locations. Because quick-service restaurants target hungry people with time constraints, locations in places like gas stations, airports, stadiums, and shopping areas are potentially profitable areas to set up a store. Already this has been realized and fast food chains are signing contracts to open stores in non-traditional venues. McDonald's, for example, has teamed up with Wal-Mart to serve food in the superstores.



Supplier Power

The main suppliers in the burger fast food industry provide the necessary inputs for the restaurant to operate—food suppliers, labor, and equipment suppliers. Food suppliers and labor, the most important variable costs in the restaurant industry, are numerous and therefore exhibit a low threat to profits. Equipment suppliers, on the other hand, do have some supplier power with CKE due to the proprietary charbroiling process the stores use.

While exclusive contracts with suppliers allow CKE to streamline operations by reducing search costs, they also give suppliers some supplier power. For example, CKE has renewed its contract with Coca-Cola to supply soft drinks. However, it is in the suppliers' best interest not to attempt to take advantage of supplier power since a sizeable portion of their sales comes from the fast food industry. Because of the numerous suppliers available in the market for inputs, supplier power is low.

Buyer Power

Because buyers are individuals or families, purchasing volume and therefore buyer power is low. The fast food market serves the majority of the population and buyers are not concentrated in a specific area. They do possess some power in the respect that they have many choices to make when selecting a fast food restaurant to dine at. However, because buyers buy fast food in low volume, buyer power is a minimal threat to profits.



Strategy

CKE Restaurants consists of two main components in the QSR (quick-service restaurant) industry: Carl's Jr. with about 980 restaurants in the Southwest and Hardee's (the 7th largest fast food chain) with 2,300 restaurants predominantly in the Midwest and Southeast. CKE acquired the Hardee's brand from the Santa Barbara Restaurant Group in 1997 in hopes of turning around the ailing fast-food chain, establishing nationwide presence and directly competing with the two largest fast-food chains, McDonalds and Burger King. Aside from the two core concepts, CKE owns and franchises La Salsa and the Green Burrito, two Mexican QSR's serving premium products.

The La Salsa and Green Burrito concepts are CKE's growth vehicles for the future catering to the fastest growing segment of the US population, the younger generation of Mexican immigrants. The number of La Salsa and Green Burrito restaurants is quite limited with only 100 and 31 respectively, but CKE plans to expand operations aggressively in the coming years. Already, CKE has begun dual-branding the Green Burrito with Carl's Jr., much like Taco Bell and Pizza Hut Express, with overwhelming success. Because of this success, CKE plans to add the Green Burrito concept to existing Carl's Jr. locations to increase economies of scope through product offerings and significantly boost same store sales.

Within the past year, CKE Restaurants has implemented an impressive restructuring plan for their fast food burger chains of Carl's Jr. and Hardee's. Instead of participating in the burger price war competing against the cost-leaders McDonalds and Burger King, CKE decided to divert their attention from discounted product offering (\$1 menus) in an attempt to gain market share to concentrating on premium products with higher profit margins. CKE aims to deliver their customers the ultimate fast food dining experience in order to gain customer brand loyalty. So far, results have been extremely positive.

Carl's Jr. has been a historically successful core concept of CKE Restaurants. However, the acquisition of the highly unpopular Hardee's brand in 1997 has undermined the profits of the CKE. Hardee's for some time has been plagued by poor service, stale food, inefficient management, decrepit buildings, and low sales. CKE wants to turn around the former #4 player in the QSR burger industry.

CKE started with renovating the Hardee's establishments on both the inside and outside. The outdated, dull color scheme was replaced with the brighter colors of Carl Jr. Larger windows were installed to increase natural lighting in the dining area to make the restaurants more aesthetically pleasing to the eye and to attract customers in to dine. CKE also removed the burger griddles and replaced them with the Carls Jr. char-broilers to maintain quality control in producing a consistently cooked burger patty. Last but not least, CKE renamed the Hardee's as Star Hardee's and replaced the old logo with the Carl's Jr. star. The capital-intensive transformation of the 2,300 locations is in its final stages.



The current major transformation for the Hardee's concept is the overhaul of the menu. CKE decided to cut out more than 40 menu items to focus on quality rather than quantity of the products offered. These changes in the menu are aimed at repositioning Hardee's as an upscale fast-foot chain like Carl's Jr., while retaining foods such as the popular breakfast menu. Hardee's menu is also becoming more integrated with the Carl's Jr. menu, offering the upgraded line of hamburgers named "Thickburgers" using Angus beef and coming in 1/3, 1/2, and 2/3 pound patties. By reducing the number of menu items and centering the lunch and dinner menu around Thickburgers, Hardee's and Carl's Jr. can spend more time preparing these sandwiches without sacrificing other factors that contribute to the general dining experience.

Carl's Jr. and Hardee's are closely following the business model of the largely successful fast food chain In-n-Out, where the main focus is to provide the customer with an excellent and consistent dining experience to gain customer loyalty. In-n-Out's menu is extremely limited, consisting of only three burgers and complements, but the burgers are so tasty that patrons are willing to wait in long lines to order. CKE is positioning itself to take this business model nationwide.

Thus far, CKE's campaign has been successful. By separating the Carl's Jr. and Hardee's brands from the low-margin discount burgers offered by McDonalds and Burger King, CKE has not only carved out a niche of customers willing to pay a premium for a quality product, but has also managed to increase its profit margins to over 21% at Carl's Jr. and over 11% at Hardee's. The introduction of the \$6 Burger and its variants has been well received by the masses and same store sales have increased as a result of these new product offerings. CKE's focus on a premium menu has allowed the Carl's Jr. and Hardee's concepts to enjoy higher profit margins and sales, thereby increasing the company's revenues.

Although sweeping changes have been implemented to redo around the Hardee's concept, there is still a long road ahead before Hardee's becomes profitable and completely integrated into the Carl's Jr. network. Most of the company-owned locations have been remodeled and their menus converted to the new Thickburger campaign; however, only 20% of the Hardee's franchises have adopted the new menu. CKE aims to fully replace the inundated Hardee's menu with the new Thickburger lineup within the coming months.

Blaisdell Consulting believes that the future of CKE Restaurants looks positive, but the restructuring program and redesigning of the Hardee's brand has overextended the firm. CKE took on a lot of debt with the purchase of the Santa Barbara Restaurant Group in 1997. With a current ratio at 0.3, the current assets will not be able to cover the current liabilities. CKE will need to take money from operations or borrow more money in order to stay in business.

As a temporary solution, Blaisdell Consulting recommends that CKE secure another credit facility in order to pay off maturing debt. This will give CKE an extension to find a way to raise funds in future periods. However, investors will be hesitant to purchase CKE bonds because of default risk. CKE will need to offer bonds at higher premiums to compensate for the risk and this may prove to be a somewhat expensive option.



CKE should also look into ways of reducing costs and/or increasing revenues to generate more cash. We recommend scaling back somewhat the aggressive advertising campaign CKE has implemented. By finding more innovative and cost-effective marketing tactics, CKE may still be able to draw customers into its stores while freeing up cash to reduce debt.

Blaisdell Consulting strongly recommends CKE sell off company-owned Carl's Jr. and Hardee's stores to franchisees. The selling of the stores will generate the necessary capital to pay off the debt. Service may actually be enhanced as agency problems between headquarters and the individual stores can be dealt with. CKE will of course need to implement effective monitoring. In addition, selling to franchisees passes on some risk from CKE to the franchise owners. Franchisees will benefit from receiving infrastructure support from CKE. CKE can use multi-part pricing to assure that on average franchisees earn a normal rate of return, while keeping the bulk of the profits with CKE.

Under performing stores that cannot be converted into franchises are good candidates for closure. By closing them, CKE can use the money saved to invest in operating activities.



Conclusion

CKE Restaurants has done a commendable job of turning around the ailing Hardee's chain and repositioning it to match the business model of Carl's Jr. CKE will benefit from economies of scale which will translate into lower costs, thus making CKE more competitive against discount burger leaders. On the revenue side, CKE's rollout of the "Thickburger" menu will increase profit margins to almost 20 percent—a very high margin in the fast food industry—while attracting a larger customer base. CKE will be positioned to lead the growth in the Mexican fast food sector with the acquisition and expansion of the La Salsa and The Green Burrito brands. Blaisdell Consulting foresees the outlook for CKE to be extremely positive in the long-run.

However, the short-run for CKE does not look as bright. CKE is hampered by high debt loads from the acquisition of the Santa Barbara Restaurant Group and still have a sizeable amount to pay off. CKE needs to find ways to reduce costs and boost revenues to help cover this debt. In order to do this Blaisdell Consulting recommends CKE to find cost-effective methods to draw customers to stores, sell company-owned stores to franchisees, and close under performing stores. Once CKE pays down the debt, CKE can more aggressively pursue its current strategy of selling premium products.

